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IN THE

Supreme Court of the United States

OCTOBER TERM, 1953.

No. [redacted] 92

GEORGE SCHMIDT,

Petitioner,

vs.

THE CROWELL-COLLIER PUBLISHING COMPANY and TUCKER CORPORATION,

Respondents.

PETITION FOR WRIT OF CERTIORARI to the United States Court of Appeals for the Seventh Circuit.

(Opinions Below Appended)

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PETITION FOR WRIT OF CERTIORARI
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OPINIONS BELOW.

The Court of Appeals decided this and two companion cases in one combined opinion entitled:

Schmidt v. *Esquire, Inc.*
Schmidt v. *Reader's Digest Association, Inc.*
Schmidt v. *Crowell-Collier Publishing Company,*
210 F. 2d 908
R. 83, Appendix of this Petition, p. 52

The opinion of the District Court (N. D. Ind.), unreported, so far as we know, is at R. 69, Appendix p. 49.

Three Related Petitions in this Court.

Since this petition is being filed shortly before the effective date of the new Rules, it is impossible to combine these cases in one petition as contemplated by new Rule 23, par. 5.

But a similar result is accomplished by docketing the petitions in the same order the cases are discussed in the Court of Appeals' opinion: (1) the *Crowell-Collier* case, (2) the *Readers Digest* case, (3) the *Esquire* case.

This petition in the *Crowell-Collier* case covers the common facts and questions of all three cases. The other two petitions cover the common facts and questions in skeleton form, referring to this petition for details, and then add the facts and questions peculiar to the *Reader's Digest* and *Esquire* cases.

Copies of all petitions are being served on respondents in all three cases. (Respondents have the same counsel in the *Crowell-Collier* and *Reader's Digest* cases).

JURISDICTION.

Judgment of affirmance was entered in the Court of Appeals on February 24, 1954 (R. 95) and this petition is filed ninety days thereafter on May 25, 1954. There was no petition for rehearing.

Being a civil case, jurisdiction here is based on 28 U.S.C.A. 1254 and 2101.

QUESTIONS PRESENTED FOR REVIEW.

Apart from several dicta on other subjects, two federal questions were actually decided by the Court of Appeals' opinion:

(1)

In denying plaintiff's motion to remand (R. 65), the Court holds that the citizenship of *Tucker Corporation,* for whose benefit this derivative stockholder's action is brought, "is *immaterial* for the purpose of testing *diversity*" jurisdiction of this case which was *removed* from an Indiana state court (R. 86-87), contrary to the settled doctrine that the corporation is always an indispensable party in a derivative action.

To reach this conclusion, the opinion goes into the *merits* of the complaint in fact and law, and concludes that the corporation does not have *title* to, and *right to sue* on, this cause of action. This, if true, would be a good defense in the state court after remand. But the further question is whether a District Court can turn a hearing on a plaintiff's motion to remand into a contest on the merits of his complaint.

R. 87-88, Appendix, pp. 56-58.

(2)

In sustaining defendant's motion to dismiss the complaint, the Court held that *local Bankruptcy Rule* 19 of the United States District Court for the Northern District of Illinois has *abrogated* (and other District Courts can similarly abrogate) the long established *property* doctrine that a bankruptcy trustee has power to *abandon* onerous or unprofitable assets by *his* declarations or conduct *manifesting his intent* so to do, without the necessity of an *order*

of court, and that by virtue of this abandonment the *title* to the asset passes out of the trustee and *reverts* to the bankrupt.

The complaint is predicated on this doctrine that the corporation's trustee made a valid abandonment of this cause of action to the corporation by that method without an order of court, and that thereby title and right to sue on it reverted to the corporation before this action was filed. (R. 17, par. 12a).

The opinion does not deny the sufficiency of the complaint under that doctrine, but holds, in effect that the doctrine has been *abrogated* in the Northern District of Illinois by this *local Bankruptcy Rule* 19, which the opinion construes as requiring formal petition, notice, hearing and order to accomplish any abandonment in that district regardless of any acts of the trustee. The opinion uses this Rule as the basis for affirming dismissal of the complaint.

R. 89-91, Appendix, pp. 59-61.

The importance of this last ruling is that the abrogated doctrine of abandonment rests on a long line of Supreme Court decisions construing the bankruptcy Act. This doctrine has long been (and is) recognized in every other federal and state court and has been the foundation of countless transfers of title to all kinds of property, real, personal and intangible. The doctrine has also been recognized by this Court of Appeals in at least two cases from that District since *Rule* 19 was adopted in 1949: *Schmidt* v. *United States,* (7 Cir. 1952) 198 F. 2d 32 impliedly recognizing the doctrine, and *In re Thomas* (7 Cir. 1953) 204 F. 2d 788 expressly recognizing the doctrine (page 792, point 6).

This enforcement of *local Bankruptcy Rule* 19 raises the questions: (a) Is the Court's construction of the Rule

wrong? (b) If the construction is right, is the Rule invalid because it exceeds the rule-making power of the District Court by cutting down the recognized abandonment power of trustees under the Act and Supreme Court decisions?

STATUTES AND RULES INVOLVED.

The diversity question, of course, involves the following:

"(a) Except as otherwise expressly provided by Act of Congress, any civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed by the defendant *or the defendants,* to the district court of the United States for the district and division embracing the place where such action is pending." (Our emphasis).

28 U. S. C. A. 1441(a)

"(a) A defendant *or defendants* desiring to remove any civil action or criminal prosecution from a State court shall file in the district court of the United States for the district and division within which such action is pending a verified petition containing a short and plain statement of the facts which entitle him *or them* to removal together with a copy of all process, pleadings and orders served upon him *or them* in such action." (Our emphasis).

28 U. S. C. A. 1446(a)

"(c) *If at any time* before final judgment it appears that the case was removed improvidently and without jurisdiction, the district court *shall remand* the case, and may order the payment of just costs. A certified copy of the order of remand shall be mailed by its clerk to the clerk of the State court. The State court may thereupon proceed with such case.

"(d) An order remanding a case to the State court from which it was removed is *not reviewable* on appeal or otherwise."

28 U. S. C. A. 1447(c) and (d)

The District Court's authority to adopt its local Bankruptcy Rule 19, springs from the following:

> "Rules, forms, and orders.—All necessary rules, forms, and orders as to *procedure* and for carrying the provisions of this act into force and effect shall be prescribed, and may be amended from time to time, by the Supreme Court of the United States." (July 1, 1898, c. 541, § 30, 30 Stat. 554).
>
> Sec. 30, 11 U. S. C. A. 53
>
> "Each court of bankruptcy, by action of a majority of the judges thereof, may from time to time make and amend rules governing its *practice* in proceedings under the Act *not inconsistent* with the *Act* or with these *general orders.* Copies of rules and amendments so made by any court of bankruptcy shall, upon their promulgation, be furnished to the Supreme Court of the United States." (Our emphasis)
>
> General Order No. 56

The District Court's local Bankruptcy Rule 19 reads as follows:

> "Rule 19. *As soon* after qualification as may be practicable but not later than *ten days* thereafter, the trustee, unless otherwise ordered by the court, *shall* take *possession* of all the *assets and books and records* of the bankrupt, including all books, records, property and funds in the possession of the receiver, if any, and shall provide for the safe custody and protection of the same. The trustee *may,* upon *approval* by the court, abandon any property of the bankrupt if burdensome or of no net realizable value." (Our emphasis).
>
> **Local Bankruptcy Rule 19 (D.C. N.D. Ill. 1949 Ed).**

We find no specific section of the Bankruptcy Act dealing with abandonment of assets by a Trustee, and the cases cite none. The doctrine rests upon the construction placed by the Supreme Court and other courts on those broad

sections dealing with the duties of a trustee (Sec. 47, 11 U.S.C.A. 75), the trustee's title to property (Sec. 70, 11 U.S.C.A. 110) and others.

The fact that this corporation is in a reorganization proceeding rather than an ordinary bankruptcy proceeding appears to make no difference in view of the following sections of Chapter 10:

"(§ 114) After approval of petition.—Upon the *approval of a petition,* the jurisdiction, *powers,* and duties of the court and of its *officers,* where not inconsistent with the provisions of this chapter (§ § 501 to 676 of this title), shall be the *same* as in a bankruptcy proceeding upon *adjudication.* (June 22, 1938, c. 575, § 1, 52 Stat. 884)." (Our emphasis).

Sec. 114, 11 U.S.C.A. 514

"(§ 186) Title of trustee to property.—A trustee, upon his appointment and qualification, shall be vested with *such title* as a trustee appointed under section 44 of this Act (§ 72 of this title) *would* have. (June 22, 1938, c. 575, § 1, 52 Stat. 892)." (Our emphasis).

Sec. 186, 11 U.S.C.A. 586

"(§ 187) Trustee's rights, powers and duties.—Where not inconsistent with the provisions of this chapter (§ § 501 to 676 of this title), a trustee, upon his appointment and qualifications, shall be vested with the *same rights,* be subject to the *same duties,* and exercise the *same powers* as a trustee appointed under section 44 of this Act (§ 72 of this title), and, if *authorized* by the judge, shall have and may exercise such additional rights and powers as a receiver in equity would have if appointed by a court of the United States for the property of the debtor. (June 22, 1938, c. 575, § 1, 52 Stat. 892)." (Our emphasis).

Sec. 187, 11 U.S.C.A. 587

"(§ 200) Rights in property of debtor.—Where not inconsistent with the provisions of this chapter (§ § 501 to 676 of this title), the rights, duties, and liabilities of creditors *and of all other persons* with respect to the *property* of the debtor shall be the *same,* before the approval of the petition, as in a bankruptcy pro-

ceeding before adjudication and, upon the approval of the petition, as in a bankruptcy proceeding upon adjudication. (June 22, 1938, c. 575, § 1, 52 Stat. 893)." (Our emphasis).

Sec. 200, 11 U.S.C.A. 600

In the light of those sections, both the District Court and Court of Appeals have assumed in this case, and we think correctly, that the doctrines of abandonment applicable to ordinary bankruptcy apply equally to the reorganization proceeding in question. Most of the bankruptcy cases cited in both opinions below are of the ordinary bankruptcy type. *Local Rule* 19 appears intended to apply to *both* types of proceedings. The Supreme Court applied ordinary bankruptcy doctrines and precedents in a reorganization case involving a question the converse of ours,—the right of a stockholder of the debtor to proceed with an existing stockholder's action after the proceeding was commenced and until the Trustee elected to take over the action as an asset of the estate. *Meyer* v. *Fleming*, (1946) 327 U.S. 161, 163-167, 66 S. Ct. 382, 383-386, 90 L. Ed. 595.

CONCISE STATEMENT OF THE CASE.

Complaint.

Plaintiff-Petitioner, an original stockholder of Tucker Corporation, brought this derivative stockholder's action, suing for his corporation on its cause of action against the defendant publisher for an article in its Collier's magazine in June, 1949, which, the complaint alleges, libeled the corporation, its business methods, its product (a new rear-engine automobile) and its credit (R. 13-16), and that as a proximate result of this libel "said corporation's business was greatly injured, the good name and public good will of the corporation's business and product were injured and destroyed, and its business and product were held up to public contempt and ridicule,—all to the corpora-

tion's damage in the sum of $25,000,000." (R. 16, par. 9). An additional charge is that the libel was published "with malicious intent to injure and destroy the corporation's said business and product * * * for the corrupt purpose of obtaining a sensational article for said magazine and thereby increase the magazine's circulation and enable defendant to profit from said wrong; and in secret and corrupt collusion with certain third parties, whose identity is presently unknown to plaintiff but known to defendant, who desired thereby to have said corporation's business and product injured and destroyed,"—for which additional punitive damages are claimed. (R. 17, par. 11). A money judgment for the damages is prayed. (R. 20).

To show his right and necessity for suing on his corporation's behalf, he alleges two successive events:

(a) The corporation has been (and still is) in a Chapter 10 corporate reorganization proceeding in the United States District Court for the Northern District of Illinois since its voluntary petition for reorganization was approved on March 3, 1949. But, the complaint alleges:

> "This cause of action has been *abandoned* in fact and law by the corporation's trustee to the corporation on and since February 20, 1951 and has thereby *reverted* to the corporation."
> R. 17, par. (12a)

(b) Shortly after that abandonment had revested title to the cause of action and right to sue on it in the *corporation*, plaintiff made all possible efforts to have the corporation file this complaint in its own name as plaintiff. This proved to be impossible, *not* because the corporation's officers were hostile to the plaintiff or caused it to assume an adverse *attitude* toward the object of the action (as most frequently is

the factual situation in stockholders' actions), but *because:*

> "said corporate management and board of directors is presently *incapable* of taking action and will not take action in this matter before this cause of action is outlawed and lost, *because* of the fact that they are *widely scattered* and have not met for a long time and are not likely to meet for the conduct of this or other corporate affairs, due to the aforesaid destruction of the corporation's business. Plaintiff has exhausted all means within his knowledge and command, except by this action, to have said cause of action filed on behalf of the corporation before it becomes outlawed and lost. Accordingly, it is necessary that this stockholder's action be filed forthwith in order to preserve this cause of action from being lost to the corporation.
>
> "* * * It being impossible to have the *corporation* join as a party *plaintiff* for the *reasons* aforesaid, it has been named as a formal *defendant*. However, as appears on the face of this complaint, no money judgment or other relief is sought respecting it or any of its property, save only the preservation and enforcement of this cause of action." (Our emphasis).
>
> R. 19, pars. 12(b) and 13.

This complaint was filed on March 1, 1951 (R. 13) in the Circuit Court of Lake County, Indiana, (hence, it was drafted in accord with Indiana code procedure and is not required to meet the requirements of Rule 23(b) of federal civil procedure).

Summonses out of that court were served on defendant Crowell-Collier on March 2, 1951 (R. 5, 6), and on Tucker Corporation by serving its executive vice president, Fred Rockelman, on March 6, 1951. (R. 11, 12). In this case, defendant Crowell-Collier has not contested jurisdiction of

its person as have Reader's Digest and Esquire in the other two cases. Tucker Corporation has remained passive, not appearing in the case to challenge the summons or take any part in the case.

Removal.

On the return day of the summonses, March 20, 1951, defendant Crowell-Collier filed its verified petitition for removal in the United States District Court for the Northern District of Indiana, based solely on alleged *diversity* of citizenship.

The complaint had alleged that Crowell-Collier is a *Delaware* corporation and that Tucker Corporation is a *Delaware* corporation. (R. 13). The petition for removal repeated those facts and added that the stockholder plaintiff is a citizen and resident of Illinois. (R. 3, pars. 4, 5, 6). It alleged the matter in controversy exceeds $3,000 and that the case is one where United States District Court has original jurisdiction. (R. 3, pars. 2, 3).

The petition for removal was made by Crowell-Collier alone, *without joining* or attempting to join *Tucker Corporation* which had already been served with summons returnable the same day as its own. The reason and justification which the petition states for this non-joinder (which would ordinarily be necessary under the above quoted terms of 28 U.S.C.A. 1441(a) and 1446(a) that the case "may be removed by *the* defendant or *the defendants*" filing a petition stating "the facts which entitled him *or them* to removal") is that:

> "The *complaint* in said civil action *alleges* that Tucker Corporation has been named a *formal defendant* and that no money judgment or other relief is sought respecting it. Further, said complaint alleges that in consolidated causes No. 48 B 530 in the United States District Court for the Northern District of Illinois, Eastern Division, being a corporate reorganization, said court approved a voluntary petition for reorganization of said corporation and appointed trus-

tees for the corporation; that said proceeding still continues and that John H. Chatz continues to act as trustee. Further, said complaint alleges that the *corporate management* and board of directors of defendant Tucker Corporation *are widely scattered* and have not met for a long time and are not likely to meet for the conduct of corporate affairs. For the foregoing reasons, it is *not necessary* for Tucker Corporation to join in this petition for removal." (Our emphasis.)

R. 3, par. 6.

Defendant's Motion to Dismiss Complaint.

After removal, Crowell-Collier filed its motion:

"To dismiss the action because the complaint fails to state a claim against defendant upon which relief can be granted."

R. 48.

The above motion goes on to state six reasons why the complaint fails to state a claim, which briefly are: (1) Plaintiff fails to state a good derivative action because: (a) it shows the corporate officers exercised bona fide discretion not to sue, (b) plaintiff did not exhaust his remedy of petitioning the Bankruptcy Court for an order directing the Trustee to sue, (c) the Trustee is a necessary party to this derivative action. (2) The right of action, if any, is vested solely in the trustee, and the Bankruptcy Court has exclusive jurisdiction. (3) At the time of the publication, the corporation carried on no trade and its assets had been transferred to the Trustee. (4) The publication was fair comment. (5) The gist of the complaint is that the Trustee failed in his duty to preserve the assets and reorganize. (6) No allegation of special damage. (R. 48-49).

Defendant filed with the above motion to dismiss, a certified copy of the order approving the petition for reorganization and appointing Trustees (one of whom died, leaving a single trustee), made on March 3, 1949 by the United States District Court for the Northern District of Illinois. (R. 50). The order is in customary form. It does not continue the debtor in possession but puts the Trustees in possession of the corporation's assets and business with the customary broad powers to operate the business. (R. 52-53).

Plaintiff's Motion to Remand.

After defendant's motion to dismiss was filed, but before any action thereon, plaintiff filed his motion to remand (R. 65) on the ground that *diversity jurisdiction does not exist,* because the *factual situation* alleged in the complaint and confessed in defendant's petition for removal requires alignment of Tucker Corporation *on the side of the plaintiff* in testing diversity, which makes the case *Schmidt, an Illinois citizen, and Tucker Corporation, a Delaware corporation,* vs. *Crowell-Collier, a Delaware corporation.* (R. 65).

The motion to remand asserted that there is no absolute rule governing the corporation's alignment in stockholders' derivative actions, but it must be aligned in each case according to the *real attitude* of the corporation, as fixed by its controlling officers. (R. 65).

The motion to remand asserted that the factual situation in this case clearly takes it out of the class where the corporate management causes it to assume an active *adverse attitude* toward the plaintiff and to *resist* the action as in most stockholders' actions,—that here the attitude of the corporation and its officers, so far as they had an attitude, was *favorable* toward the plaintiff's action and *adverse to*

the defendant from the very *nature* of the case, because the published article had libeled the corporation and its officers *together* (though their individual causes of action are separate from the present one). (R. 66).

The motion to remand also asserted that defendant's failure or inability to have Tucker Corporation *join* in the petition for removal *was itself fatal to the removal* under 28 U.S.C.A. 1441(a) and 1446(a) *except* for the *excuse* stated in the petition that the corporation in fact had *no interest on defendant's side* (R. 3, par. 6), and that this confession required alignment of the corporation on the side of the plaintiff,—so federal jurisdiction was destroyed either way. (R. 67, par. e).

Hearing and Decision in the District Court.

The District Court chose to hear plaintiff's jurisdictional motion to remand and defendant's motion to dismiss the complaint on its merits, together (R. 68), and later decided both motions together in one opinion. (R. 69).

The opinion, adopting defendant's argument, sought to avoid (and never did decide) the question of which side the corporation should be aligned on, by adopting the premise that:

> "The question of allignment does not arise however if Tucker Corporation is not a necessary party because only indispensible parties need be regarded in testing diversity."
>
> R. 69, also Appendix, p. 49.

Almost the entire remainder of the opinion is devoted to an attempted demonstration that the corporation has no *title* to this cause of action, that title is still vested in the trustee, and *therefore:* "It follows that under such circumstances the corporation is not a necessary party but is merely nominal." (R. 70, Appendix, p. 50).

The District Court's opinion holds there was no abandonment of this asset by the trustee to the corporation. But it makes no mention of *local Bankruptcy Rule* 19 in the Northern District of Illinois. It bases the ruling squarely on the supposed general proposition that there cannot be an abandonment of an asset by a Trustee in any case except "through an order of court." (R. 70, bottom). This ruling is based on an Illinois Appellate Court opinion (discussed *infra*) which the opinion "adopts." (R. 71, top). *All this* is decided as the *basis* for denying the plaintiff's *motion to remand.* (R. 71, top, Appendix, p. 51).

When the opinion comes to dismiss the merits of the case on defendant's motion to dismiss the complaint for failure to state a claim, it merely *adopts* the *same points* and *authorities* already used *in denying the motion to remand,* apparently recognizing that it had *covered the merits* of the case *in deciding the motion to remand.* (R. 71, Appendix, p. 51).

The Court of Appeals' Opinion.

This opinion (R. 83, Appendix, p. 52) reaches the same result as the District Court's opinion.

On the motion to remand, it holds that the corporation's citizenship "is *immaterial* for the purpose of testing diversity," *because* the corporation has no *title* to, or *right* to prosecute, the action,—that the cause of action is still vested in the Trustee.

R. 86-87, Appendix, pp. 56-58.
210 F. 2d at pp. 912-913, points 1-6.

On the motion to dismiss, it holds that there was no abandonment. But it does not base this on a blanket ruling that a court order is necessary *everywhere* to cause an

abandonment, as did the District Court. It recognizes the Supreme Court precedents and the general doctrine that a trustee *can* abandon assets without any order of court by manifesting *his* intent so to do by words or conduct, and that—

> "*whether* abandonment has *occurred* in a *particular* case is usually a question of *fact.*"

R. 89, Appendix, p. 59.

210 F. 2d at p. 913, point 8.

But it predicates lack of abandonment of this asset, and consequent lack of title in the corporation, on its interpretation of one sentence in *local Bankruptcy Rule* 19 of the United States District Court for the Northern District of Illinois, which says that: "The trustee *may,* upon *approval* by the court, abandon any property of the bankrupt if burdensome or of no net realizable value." (Our italics). (Rule quoted at p. 6 *supra.*) It construes this to mean that *no abandonment* of *any* asset *can* occur in that District (or has lawfully occurred in any of the hundreds of bankruptcies there since the Rule was adopted in 1949), *except* by a formal recorded *order,* preceded apparently by "a formal petition, notice, and hearing in order to secure the approval of the court for the abandonment."

R. 90-91, Appendix, pp. 60-61.

210 F. 2d at p. 914, points 10 and 11.

Express Nature of the Trustee's Abandonment.

The Court of Appeals' opinion omits to state the complaint's basic allegation of abandonment which in itself is probably sufficient to repel a motion to dismiss:

> "(a) This cause of action has been *abandoned in fact and law* by the corporation's trustee to the corporation *on and since February* 20, 1951 and has thereby *reverted* to the corporation."

This is followed by evidentiary allegations, including:

> " * * * On Tuesday, February 20, 1951, plaintiff's counsel, Jay E. Darlington, * * * stated in substance to the officially appointed and *duly authorized* counsel for said trustee, Norman H. Nachman, that he considered this cause of action valuable to the corporation and meritorious, that same was in danger of being outlawed and lost on or shortly after March 3, 1951, and requested said counsel for the trustee to file and prosecute same before it became outlawed and lost * * *. In response thereto said counsel for the trustee stated in substance that he had been considering this matter and *had then reached the conclusion that he would not do so,* and that he considered this cause of action to be non-existent and *not an asset of the corporation's estate.*"
>
> R. 17-18, par. 12(a).

There follows an allegation that *after* the above abandonment, plaintiff's counsel wrote a letter *to trustee's counsel* on February 23, 1951, in which he "notified said counsel that he intended to file this stockholders' action upon said cause of action *as an asset which had been abandoned* in fact and law *by the trustee* * * *", copies of the letter being sent to the Trustee and court. The obvious purpose of the letter and copies was (1) to confirm the prior conversation, (2) to notify the Trustee of his counsel's declarations on his behalf and avoid any contention that his counsel acted without his knowledge or authority, (3) the precaution of making it clear that the plaintiff was acting in good faith and not intending to tamper with an asset still in the estate.

Contrary to the confused misinterpretation of our position in the opinion (R. 90) we never treated this letter as *constituting* the abandonment. It was the previously ex-

pressed intent of the trustee on February 20, coupled with his previous long ignoring of the asset until it was nearly ready to perish, which produced that result.

Neither have we ever proceeded on the theory that this abandonment was an act of the *court* (that false and confusing idea has been urged in the defendant's arguments and has found its way into the opinions). In this type of abandonment without order, it is not the *court* but the *trustee* who makes the abandonment as *his administrative act*, consisting of *his intent* to abandon and some *manifestation* of it by him,—as shown by all the cases on the subject, *infra*.

Trustee has Never Re-asserted Title to this Cause of Action.

The record shows that after his express and willing abandonment three years ago, the Trustee has never made any attempt to deny or object to the corporation's title to this action or the plaintiff's right to prosecute it. The Trustee, apparently recognizing that the abandonment took the asset out of the estate, has remained silent and indifferent to it.

Neither has the Bankruptcy Court or any party in the reorganization proceeding ever made any objection to the abandonment or to this action, or asserted any interest or concern with it.

Defendant's Attempt to Set Up the Trustee's Title for its own Defense.

The defendant is a total stranger to the reorganization proceeding,—yet its motion to dismiss attacks the complaint primarily by setting up the alleged rights of the Trustee and the Bankruptcy Court (R. 48), while setting

up its own affirmative defenses secondarily. (R. 49). It has urged *only the Trustee's rights* below, as indicated by the fact that both opinions below are devoted to those contentions.

That a stranger cannot set up the Trustee's alleged rights as a shield for his own wrong, see the cases at page 46 *infra*.

Cause of Action Would be Outlawed and Worthless if Still Vested in Trustee.

Neither the Trustee or anybody else ever filed any action for the corporation on this gross and malicious tort, except the one at bar, which, the record shows, the plaintiff has prosecuted with great labor and considerable expense.

Any action by the Trustee would now be outlawed. The goal of defendant in urging that the action is "vested" in the Trustee (R. 48), and the result of the opinion to that effect, is only to keep the cause of action in the estate for burial.

ARGUMENT.

An unusual feature of the Court of Appeals' opinion, possibly indicating difficulty in finding or agreeing upon grounds for the decision, is the fact that it repeatedly starts out as if to decide a point and then leaves the point hanging in mid air and places the decision on a different point. This results in a series of alternate *dicta* and points decided.

I.

Lack of Diversity Jurisdiction.

The Corporation must be aligned on the plaintiff's side in this case.

The true question on the motion to remand, which cannot be avoided below or here, is which side Tucker Corporation must be aligned on.

The opinion suggests, but does not decide, that the corporation should *always* be aligned on the defendant's side regardless of whether the attitude of the corporation and its management is hostile or friendly toward the plaintiff's action. (R. 87, 210 F. 2d at p. 912, point 1). Appendix, p. 56.

But this is refuted by the fact that all the cases it cites of the "hostile" type, take great pains to place the corporation's alignment on the defendant's side on *that* ground. If alignment on the defendant's side were automatic and inevitable in all derivative actions, why such needless and misleading effort in the opinions. See, for instance, the statement that the corporation is aligned on the defendant's side "*because* the corporation is in antagonistic hands", *Koster* v. *Lumbermen's Mutual Casualty Co.* (1947), 330 U. S. 518, 523, 67 S. Ct. 828, 831, 91 L. Ed.

1067, and the careful demonstration of adversity between stockholder and corporation, followed by the statement that:

> "The question of jurisdiction must be decided, having reference to the *attitude* of the case at the date the bill was filed."
>
> *City of Chicago* v. *Mills* (1907) 204 U.S. 321, 27 S. Ct. 286, 288, 51 L. Ed. 504.

Recent texts repeatedly state that the corporation is to be aligned with the plaintiff stockholder in the non-hostile type of situation:

> "Stockholders' suits. In a suit by a stockholder of a corporation to enforce a right of the corporation, the corporation is properly aligned as a *defendant* where *it takes a position antagonistic* to plaintiff and is *under the control* of another defendant; *but,* where the *corporation or those in control* of the corporation are *not opposed* to the *object* sought by plaintiff, or where plaintiff is in control of the corporation, *the corporation ordinarily should be aligned with plaintiff.*" (Our emphasis.)
>
> 76 C.J.S., Removal of Causes, Sec. 129, page 1000.

> "The rule which aligns parties according to interest does not apply to stockholders' suits brought against the corporation and others on a cause of action existing in favor of the corporation, where such suit is not collusive but is brought by plaintiff because the corporation is controlled by interests *antagonistic* to him, but, *where* such *hostility* on the part of the controlling interests in the corporation is *not shown,* or the suit is collusive, the usual rule applies that parties *must* be aligned according to their interest for the purpose of determining the jurisdiction of the federal

courts and *the corporation will be aligned with plaintiff.*" (Our emphasis.)

35 C.J.S., Federal Courts, sec. 59, page 885, at note 92.

A frequently cited case states:

"The rule deduced from them (cases) is that, in a suit in equity instituted by a stockholder in his own name, but upon a *right of action* existing in his *corporation,* the stockholder's corporation will be aligned with the defendants *whenever* the officers or persons *controlling* the corporation are *shown* to be *opposed* to the *object* sought by the complaining stockholder, and that, *when such opposition does not appear,* the stockholder's *corporation will be aligned with the complainant* in the suit."

Groel v. *United Electric Co.* (C.C. N. J. 1904, 132 F. 252, 263.

The following recent case was where a Kentucky statute required joining the corporation on the plaintiff's side in stockholders' suits, but the court went on to place its decision on the following additional ground:

"There is a *second reason* why the motion to realign should be granted. As will appear below, the amended complaint does not *allege* sufficient facts to sustain the contention that its directors and stockholders would *necessarily* have *declined,* upon demand, to bring legal action to enforce such claims as the Corporation may have had against the individual defendants. It follows that the *special* rule that a corporation will be re-aligned as a *defendant* in a stockholder derivative action, *when* its management is *friendly to the defendant* and *hostile* to the plaintiff, has *no application;* and under the general rule first established in *Pacific R. R. Co.* v. *Ketchum,* 1880, 101 U. S. 289, 25 L. Ed. 932 the Corporation *should be aligned as a plaintiff* because recovery is sought in its behalf. See also *Koster* v. (*American*) *Lumbermen's*

Mutual Casualty Co., 330 U. S. 518, 522-523, 67 S. Ct. 828, 91 L. Ed. 1067." (Our emphasis.)

Levitan v. *Stout* (D. C. Ky. 1951), 97 F. Supp. 105, 113.

The following is a recent case applying the above doctrine, in which the state court denied a removal petition for insufficiency on its face. It quotes and follows the passage from *Groel* v. *United Electric Co.*, 132 F. 252, 263, which we have quoted *supra*:

Taylor v. *Cornman Construction Co.* (1945), 136 N. J. Eq. 252, 41 A. 2d 208, 212, points 5 and 6.

A significant feature of the passage we have quoted *supra* from *Groel* v. *United Electric Co.*, 132 F. 252, 263, and which is quoted and followed in the last cited New Jersey case, is that "when such *opposition* (between the suing stockholder and the corporate management) *does not appear*, a stockholder's corporation *will be* aligned with the *complainant* in the suit,"—thereby making the corporation *prima facie* subject to alignment on the plaintiff's side and placing the *burden* of showing hostility between the stockholder and corporate management on those seeking to assert it. Moreover, this showing can only come from the face of the complaint on a motion to remand as shown at pages ~~28-33~~ 30-33, *infra*.

Another feature of the last cited New Jersey case and the previously quoted case of *Levitan* v. *Stout*, 97 F. Supp. 105, 113, is that they recognize and cite the leading cases relied on by defendant below (though not in the lower court's opinion), *Doctor* v. *Harrington*, 196 U. S. 579, 25 S. Ct. 355 (cited in 41 A. 2d at p. 212), and *Koster* v. *Lumbermen's Mutual Casualty Co.*, 330 U. S. 518, 522, 67 S .Ct. 828, 830 (cited in 97 F. Supp. at p. 113). But they correctly cite those cases as authorities on the hostile type of stockholder's suit and clearly show that those cases do not *exclude* or *cover* the non-hostile type.

Defendant's failure to join corporation in its petition for removal admits that the corporation should be aligned in this case on the plaintiff's side.

The present removal statute (28 U. S. C. 1441 (a)), which has been similar in this respect since 1887, grants the right of removal to "the defendants" if there are more than one, and this has long been held to require *joinder in the petition* by "*all* the parties on the *same side* of the *controversy*":

> "Under the 1st clause of § 2 of the act of 1875 (18 Stat. at L. 470, chap. 137), which applied to '*either party,*' but in its re-enactment in the 2d clause of § 2 of the act of 1887, above quoted, is confined to the defendant *or defendants,* it was well settled that a removal could not be effected *unless all the parties on the same side of the controversy united in the petition.* * * *" (Our emphasis.)
>
> *Chicago, R. I & P. R. Co.* v. *Martin* (1900), 178 U. S. 245, 20 S. Ct. 854, 855.

"Under the provisions of Section 1446, Title 28 U. S. C. A., as amended by the Act of May 24, 1949, the defendant, Connecticut General Life Insurance Company, cannot *now* file a petition for removal and, *since it did not join* with the defendant, Virginia B. Whiteside, in her petition for removal, the *motion to remand should be granted.*

"In *Johnson* v. *March,* D. C. Neb., 49 F. Supp. 137, 141, in an opinion rendered March 18, 1943, Judge Delehant said:

> " 'In the absence of a separable controversy it is *necessary* to removal that *all the defendants properly included by the plaintiff* in the action *join in*

the petition for removal and be lawfully entitled to remove.' " (Our emphasis.)

Board of Directors v. *Whiteside* (D. C. Ark. 1949), 87 F. Supp. 69, 72.

Attempt to Avoid Deciding the Alignment Question by "Disregarding" the Corporation.

After discussing the alignment question a while, and making some erroneous *dicta,* the opinion attempts to avoid deciding the question by saying (as had the District Court):

> "However, we need not further consider the plaintiff's theory of alignment, for we think the District Court ruled correctly that under the circumstances of this case the citizenship of the Tucker Corporation is *immaterial* for the purpose of *testing diversity.*" (Our emphasis.)
>
> R. 87, 210 F. 2d at p. 912. Appendix, p. 56.

Then it goes on to demonstrate (erroneously) that the *title* to the action is still *vested* in the Trustee, following which it repeats the above doctrine:

> "Under these circumstances, we think the *corporation* could rightly be *disregarded* as a *party* to the suit. Its citizenship was *not,* therefore, *revelant* to the question of *diversity jurisdiction.*"
>
> R. 88, 210 F. 2d at p. 913, point 6. Appendix, p. 58.

This runs afoul of two basic jurisdictional doctrines: (1) that the corporation is always an indispensable party in a derivative action, and (2) the District Court is not permitted to go into the merits of the complaint in deciding a motion to remand.

The Corporation is Always an Indispensable Party in a Derivative Action.

The previously cited recent case, *Taylor* v. *Cornman Construction Co.* (1945) 136 N.J. Eq. 252, 41 A. 2d 208, also

quotes and adopts the case which we have previously quoted, *Groel* v. *United Electrical Co.,* 132 F. 252, at p. 254, as follows:

> " 'The New Jersey company, in the case now under consideration, *cannot* be considered a merely formal or nominal party. It is a *necessary* and *indispensable* party. The case *could not proceed without it.* The complainant seeks relief in *its* behalf because it will not seek it for itself. As it will not voluntarily act as complainant, the practice in equity *requires* that it *shall be brought in* as a party defendant. It follows that, in determining the question of jurisdiction, *its citizenship cannot be ignored.* But the *mere fact* that it stands as a defendant on the face of the pleadings does not fix its status in the controversy. That is fixed by *its real relation to the controversy. Whether* that relation requires it to be ranged *with the complainant* or with the Pennsylvania company *as a party defendant,* is the question presented in this case'." (Our emphasis.)
>
> *Taylor* v. *Cornman Const. Co.* (C.C. N.J. 1945) 41 A. 2d 208, 212, 136 N.J. Eq. 252.

And the same doctrine is stated in the following recent text:

> "The corporation is a proper and *indispensable* party to a suit brought by one or more stockholders for its benefit. *A failure* to make it a party is not a mere defect of parties; *it leaves the stockholder without a cause of action and the court without jurisdiction.* In such case the suit should be dismissed, or if a decree is rendered it may be set aside." (Our emphasis.)
>
> 18 C. J. S., Corporations, Sec. 570, page 1293.

This requirement at the threshold of every stockholder's suit is fundamental and *inherent* in the *nature* of the suit. It is for the protection of the real defendant in the case, among other reasons, as shown by the following leading cases which are mentioned but misapplied in the opinion below:

> "Such a (stockholder's) suit can only be maintained on the ground that the *rights* of the *corporation* are

involved. * * * Manifestly the proceedings for this purpose should be so conducted that any decree which *shall* be made on the merits shall *conclude the corporation.* This can *only* be done by making the *corporation* a party defendant. The relief asked is on *behalf* of the Corporation, not the individual shareholder; and *if* it be granted, the complainant derives only an incidental benefit from it." (Our emphasis.)

City of Davenport v. *Dows* (1874) 85 U. S. 626, 21 L. Ed. 938.

"The corporation is a *necessary party. City of Davenport* v. *Dows,* 18 Wall, 626, 21 L. Ed. 938. *Hence,* it is joined as a *defendant.* But it is *only nominally a defendant,* since *any judgment obtained* against the *real defendant* runs in *its* favor." (Our emphasis.)

Meyer v. *Fleming* (1946) 327 U. S. 161, 167, 66 S. Ct. 382, 386, 90 L. Ed. 595.

Also, as seems hardly necessary to point out, the above doctrine does not require that the stockholder be *successful* (or that the court determine the merits ahead of time to ascertain if he will be successful) in establishing his *capacity* to sue for the corporation and that the latter *has a cause of action.* This would place an impossible requirement upon the stockholder and judge of foretelling the future in determining the initial question of who are necessary or indispensable parties. Both the above cases recognize this by saying that "*if* it (relief) be granted" it belongs to the corporation, or that "*any* judgment obtained" is in favor of the corporation.

Merits of Plaintiff's Case Cannot Be Gone Into by Defendant on Motion to Remand.

Underlying policy to restrict diversity jurisdiction.

The strict doctrine against going into any aspect of the merits of the plaintiff's case on a motion to remand, rests upon fundamental principles.

In a case which was not a stockholder's suit but involved some applicable doctrines, the Supreme Court held that the parties must be re-aligned so as to transfer a named defendant to the plaintiff's side when they were "partners in litigation" (314 U. S. at p. 74),—a phrase strongly applicable to a stockholder's suit,—and then went on to state the following strict limitations upon diversity jurisdiction and two reasons therefor: (1) to reduce the burden of non-federal litigation which comes to the federal courts through diversity and (2) respect for the constitutional position of the states and their courts:

> "The dominant note in the successive enactments of Congress relating to *diversity* jurisdiction is one of jealous restriction, of avoiding offense to state sensitiveness, and of *relieving the federal courts of the overwhelming burden* of 'business that intrinsically belongs to the state courts' in order to keep them free for their distinctive federal business. * * * The power reserved to the states, under the Constitution (Amendment 10), to provide for the determination of controversies in *their* courts, may be restricted only by the action of Congress in conformity to the judiciary sections of the Constitution (article 3). * * Due regard to the rightful *independence of state governments,* which should actuate federal courts, requires that they *scrupulously confine* their own jurisdiction to the *precise limits* which the statute has defined." (Our emphasis.)
>
> *City of Indianapolis* v. *Chase National Bank* (1941), 314 U. S. 63, 76-77, 62 S. Ct. 15, 20.

In the following case the same result was predicated upon the additional ground of avoiding "interruption of the litigation of the merits" of cases in the state court by improper removal,—the Supreme Court saying the policy

was so strong that it applies to the United States as a civil litigant the same as to other litigants:

> "But the Congressional policy of avoiding *interruption* of the litigation of the *merits* of removed causes, *properly begun in state courts,* is as pertinent to those removed by the United States as by any other suitor, * * *" (Our emphasis.)
>
> *United States* v. *Rice* (1946), 327 U. S. 742, 752, 66 S. Ct. 835, 839, 90 L. Ed. 982.

In the following more recent case the Supreme Court (dealing with a question of removal of separable controversies which is not the type of diversity involved in our case), states general principles which are applicable, namely: that the 1948 Judicial Code does not enlarge but shows a Congressional policy to further "abridge the right of removal" in certain respects (341 U. S. at p. 10) and that "the jurisdiction of the federal courts is carefully guarded against *expansion by judicial interpretation* or by prior action or consent of the parties" (pp. 17-18). The case also dramatically illustrates the consequence of improper removal by holding that a defendant who improperly removed a case could nevertheless challenge the diversity after judgment went against it:

> *American Fire & Casualty Co.* v. *Finn* (1951) 341 U. S. 6, 17-18, 71 S. Ct. 534, 538, 542.

Applying the above doctrines to the question of whether and how far a federal court can go into the merits of the case on a question of remand:

In the following case, removed without objection or motion to remand, and decided on the merits in the federal Circuit Court, the Supreme Court upon discovering a lack of diversity, upon its own motion, ordered the case remanded and held (1) diversity must *affirmatively* appear

on the face of the record, and (2) remand must be made "without inquiry into the merits".

Hancock v. *Holbrook* (1884) 112 U. S. 229, 5 S. Ct. 115, 116.

The above doctrine against "inquiry into the merits" precludes the determination of "doubtful issues of fact or law" and also precludes passing upon the sufficiency of pleadings:

> "In considering the motion to remand, the court *will not pass on the merits* of the controversy or cause of action or on the sufficiency of the testimony as on an application for a nonsuit; it is *not the province* of the court in passing on a motion to remand to *determine doubtful issues of law or fact.* In general, the court will not pass on the *sufficiency* of the pleadings, or at least it will not pass on the sufficiency of the allegation as on a demurrer." (Our emphasis.)
>
> 76 C. J. S., Removal of Causes, Sec. 305, page 1150.

The same doctrine also requires that inquiry be confined to the face of plaintiff's pleadings, with all doubts resolved in his favor:

> "In determining whether the cause is within the removal statutes so as to require denial of a remand, the court will consider, and *consider only,* the *allegations of plaintiff's pleadings,* which, for the purpose of determining whether to remand, *must be taken as true and at their face value.* As sometimes stated, *plaintiff's pleading* is the 'frame of reference,' and the *only criterion* to be used by the court in making its determination. While plaintiff must show that he is entitled *on his pleadings* to the jurisdiction of the court to which he seeks to have the case remanded, his cause of action *must be accepted as pleaded,* and *any doubt* must be *resolved in his favor.*" (Our emphasis.)
>
> 76 C. J. S., Removal of Causes, Sec. 305, page 1151.

"the court will not inquire, on a motion to remand a case to the state court, either as to the *truth of the allegations in the pleadings, or the sufficiency of the complaint* or bill as such, or whether it states a good cause of action. These matters are for the decision of the court which finally tries the case." (Our emphasis.)

Brown v. *House* (D. C. S. D. 1927), 20 F. 2d 142, 143.

The last quoted doctrine also precludes the defendant from arguing the merits of the plaintiff's "claimed right" to bring the action solely in his *own name* and the alleged "infirmity of his allegations in his complaint or petition of such right":

"The second such feature is the *obviously tenuous basis* of any *claimed right* of the plaintiff *in his own name* to bring a direct action against the Company on any bond whose existence he may prove, and the *infirmity* even of his *allegation* in his complaint or petition of such a right. But that consideration also is inappropriate for determination upon a motion to remand. *Broadway Ins. Co.* v. *Chicago, G. W. R. Co.*, C. C. W. D. Mo., 101 F. 507; *Johnson* v. *Marsh*, *supra*. The proper *disposition* of his claim against the Company, first upon its *pleading*, and thereafter, if necessary, upon its proof, *must* be *returned* to the state court." (Our emphasis.)

Doran v. *Elgin Co-operative Credit Ass'n.* (D. C. Neb. 1950), 95 F. Supp. 455, 459.

Further, for purposes of remand, the defendant is not permitted to avoid the above doctrines by pointing to allegations in his removal petition which are inconsistent with the case made by the complaint:

"The *complaint* itself determines, *not* the allegations in the *petition*." (Citing Supreme Court cases.) (Our emphasis.)

Delaware L. & W. R. Co. v. *Slocum* (D. C. New York, 1944), 56 F. Supp. 634, 637, point 8.

Similarly, defendant is not permitted to sustain the removal by raising or arguing a new matter of controversy with the plaintiff:

> "Defendant *cannot allege any new matter* in controversy as grounds for removal." (Our emphasis.)
>
> *Doggett* v. *Hunt* (D. C. Ala. 1950), 93 F. Supp. 426, 428, point 4.

Neither can removability be sustained by either the defendant producing *evidence* going to the merits or the Federal Court making an *order* on the merits:

> "But it is equally well settled that, where there is no claim of a fraudulent attempt to evade a removal, a case not removable when commenced *cannot* be *converted* into a removable one by *evidence of the defendant* or by an *order of the court* upon an issue on the *merits;* but can only be accomplished by the voluntary action of the plaintiff." (Citing Supreme Court cases.) (Our emphasis.)
>
> *Halsey* v. *Minnesota-South Carolina Land & Timber Co.* (D. C. S. C. 1932), 54 F. 2d 933, 935.

Likewise applicable is the doctrine that in examining the complaint on a motion to remand, the complaint must be construed in the *light most favorable to the plaintiff* with all intendments taken in plaintiff's favor as against removal (*Thurston* v. *Northwestern Fire & Marine Ins. Co.* (D. C. New York 1934), 9 F. Supp. 848, 853, points 7 and 9). This doctrine also precludes argument in defendant's brief that the plaintiff has allegedly been defeated in prior cases or that prior litigation is *res adjudicata* against the plaintiff (last cited case, p. 856).

Likewise, defendant is not permitted to take isolated allegations of the complaint and "draw from them inferences favorable to the defendant's theory" contrary to

the general tenor of the complaint and the plaintiff's apparent theory. (*Babb* v. *Paul Revere Life Ins. Co.* (D. C. S. C. 1952), 102 F. Supp. 247, 251, point 8.)

Also applicable is the doctrine (grounded upon the Supreme Court precedents cited at the beginning of this section) that—

> "the case should be remanded where there is *any doubt* as to the right of removal in the first instance."
>
> *Reeves* v. *American Brake Shoe Co.* (D. C. Mo. 1947), 74 F. Supp. 897, 899, point 5.
>
> *Babb* v. *Paul Revere Life Ins. Co.* (D. C. S. C. 1952), 102 F. Supp. 247, 251, point 3.

Jurisdiction Must Be Established Before Any Other Question Is Considered.

This elementary doctrine, flowing from the principles discussed under the last preceding heading, would need no mention except for the fact that the Court's opinion below mistakenly violates it. While the opinion takes up the jurisdictional question first, it actually goes into and decides a question on the merits (whether the corporation obtained title to the cause of action through abandonment) in order to hold that the corporation is not an indispensable party and thereby sustained the jurisdiction.

> "From the authorities referred to, the conclusion seems inescapable that the duty devolves upon the court 'at any time' the jurisdictional question is presented to *proceed no further until that question is determined.*" (Our emphasis.)
>
> *Page* v. *Wright* (7 Cir. 1940), 116 F. 2d 449, 453.

To the same effect, and also adding the doctrine that this function of first determining jurisdiction is "ever present and self-asserting" and that "the court must on

its own motion consider it regardless of whether raised by the parties," see

Chicago B. & Q. R. Co. v. *Willard* (1911), 220 U. S. 413, 31 S. Ct. 460, 461-462.

Schell v. *Food Machinery Corporation* (5 Cir. 1937) 87 F. 2d 385, 387, certiorari denied, 300 U. S. 679.

II.

The General Law of Abandonment of Assets by Trustee.

Unlike the District Court's opinion which refused to recognize that there is or can be such a thing in the law (R. 70), the Court of Appeals' opinion concedes there is a general doctrine whereby a trustee can make an abandonment *of the kind alleged in the complaint* without court order:

> "* * * It is *true*, as a *general principle* of law, that a trustee in bankruptcy *may abandon* onerous or unprofitable assets. *Dushane* v. *Beall*, 161 U.S. 513, 16 S. Ct. 637, 40 L. Ed. 791; *In re: Thomas*, 7 Cir., 204 F. 2d 788; *In re: Malcom*, D.C., 48 F. Supp. 675. It is likewise *certain* that *title* to abandoned assets *thereupon revests* in the *bankrupt*. *Brown* v. *O'Keefe*, 300 U.S. 598, 57 S. Ct. 543, 81 L. Ed. 827; *In re: Webb*, 4 Cir., 54 F. 2d 1065. It is *not so certain* just what *action* by the *trustee* is necessary to *constitute* an abandonment. There is no universally applied formula which *he* is required to follow, and whether abandonment has occurred in a particular case is *usually a question of fact*. *Stanolind Oil & Gas Co.* v. *Logan*, 5 Cir., 92 F. 2d 28. The trustee *may expressly declare* his intent to abandon. *Sessions* v. *Romadka*, 145 U.S. 29, 12 S. Ct. 799, 36 L. Ed. 609, while in some cases a *mere failure* by the *trustee* to *administer* property of

which he has knowledge has been held sufficient. *Sparhawk* v. *Yerkes,* 142 U.S. 1, 12 S. Ct. 104, 35 L. Ed. 915; *Mills Novelty Co.* v. *Monarch Tool & Mfg. Co.,* 6 Cir., 49 F. 2d 28. *See Judge Lindley's* extensive discussion in *In re: Malcom,* D.C., 48 F. Supp. 675. (Our emphasis).

R. 89, 210 F. 2d at p. 913, point 8. Appendix, 58-59.

The Court could hardly say otherwise, because eight months earlier it had announced the same doctrine:

"*There can be no denial of the principle* of law that a *trustee* in bankruptcy is *not obliged* to accept, and *may abandon,* onerous assets which the bankrupt has disclosed and surrendered, and that *upon* such abandonment, title thereto *revests* in the bankrupt. The question is whether that principle is applicable to the facts of the instant case.

• • •

"We need not attempt a detailed analysis of the many cases relative to the *law of abandonment* pronounced under *a variety of circumstances.* The principal cases relied upon by the bankrupt are *Sparhawk* v. *Yerkes,* 142 U.S. 1, 12 S. Ct. 104, 35 L. Ed. 915; *Dushane* v. *Beall,* 161 U.S. 513, 16 S. Ct. 637, 40 L. Ed. 791; *Brown* v. *O'Keefe,* 300 U.S. 598, 57 S. Ct. 543, 81 L. Ed. 827; *In re: Webb,* 4 Cir., 54 F. 2d, 1065; *In re: Ferribee,* 7 Cir., 93 F. 2d 262, 263; and *In re: Malcom,* D.C. 48 F. Supp. 675. There is at least one ground, however, which distinguishes all of these from the instant case, that is, the *trustee or* the court was dealing with a situation wherein the bankrupt had scheduled the asset which the *trustee found* worthless *and abandoned.* There is no case, so far as we are aware, which has sustained an abandonment by a bankruptcy *trustee* of non-scheduled property, the ownership of which was denied or concealed by the bankrupt. A pertinent observation is contained in *First National Bank of Jacksboro* v. *Lasater,* 196 U.S. 115, 118, 25 S. Ct. 206, 208, 49 L. Ed. 408, wherein the court stated:

'We have held that *trustees* in bankruptcy are not bound to *accept* property of an onerous or unprofitable character, and that *they* have a reasonable time in which to elect whether *they* will accept or not. If *they* decline to take the property, the *bankrupt can assert title thereto.* (Citing cases). But that doctrine can have no application when the trustee is ignorant of the existence of the property, and has had no opportunity to make an election. * * *'' (Our emphasis).

In re: *Thomas* (7 Cir. 1953) 204 F. 2d 788, 793-794.

Local Bankruptcy Rule 19 is Misconstrued or Invalid.

The opinion proceeds to deprive this corporation (and all bankrupt litigants in the Northern District of Illinois since 1949 and in the future) of the benefits of the above quoted doctrine of abandonment by a trustee:

"It is *generally assumed* that an *order* of the bankruptcy court is *not requisite* to the abandonment of property by the trustee. * * * The District Court for the Northern District of Illinois has adopted a rule, *Bankruptcy Rule* 19, which provides in part: 'The trustee may, *upon approval by the court,* abandon any property of the bankrupt if burdensome or of no net realizable value.' (Our emphasis). The Bankruptcy Court, in the exercise of its paramount authority, *could* adopt this rule as a governing requirement in the administration of bankruptcy matters in *that* court. Thus, we think it clear, in the instant case, that the trustee *could not* abandon the claim for libel without securing the court's *approval.*" (Our emphasis).

R. 89-90, 210 F. 2d 913-914. Appendix, pp. 59-61.

Then it proceeds to construe the Rule as requiring a formal order:

"The court in which this bankruptcy proceeding was pending was, of course, a court of record. *It* acts *only* through its *orders* which are made of record. *It* could *approve* the abandonment of these causes of action *only* by an *order* duly entered. *Since* no such

order was entered the court did not approve the abandonment. *Schmidt* v. *Crowell-Collier Publishing Co.*, 349 Ill. App. 229, 234, 110 N. E. 2d 464." (Our emphasis).

R. 90, 210 F. 2d at p. 914. Appendix, p. 61.

It seems doubtful that the Rule bears this construction. If the judges had intended an order they would have used the word. In its context, this sentence seems to be permissive and directive, rather than mandatory and exclusive.

Moreover, this appears to be the first announcement of this construction since the Rule was adopted in 1949. The above quoted *In re Thomas* (1953) 204 F. 2d 788 went up from that District and the opinion is expressly contrary. Further, in *Schmidt* v. *United States* (1952) 198 F. 2d 32, cert. den. 344 U.S. 896, this same stockholder, Schmidt, had an almost identical complaint in that District Court based on the abandonment of another cause of action by the same Trustee at the same time. The Court of Appeals entertained his case *on the merits* and construed two important federal statutes, the Tort Claims Act and the S. E. C. statute, which is hardly consistent with the present doctrine that Rule 19 precluded any abandonment and made the plaintiff and his corporation mere interlopers.

This Court has ample review power to (1) correct this mis-construction of *local Bankruptcy Rule* 19, or (2) strike it down because, as now construed, it cuts down the powers of trustees under the Act, it casts doubt on many transfers of property by such abandonments without orders in this large District since 1949, and it will deprive bankrupts of equal property privileges as compared with other Districts in the future. The following cases struck down various rules for less serious infringements:

"The authority conferred upon this court by section 30 of the Bankruptcy Act (Comp. St. § 9614) to pre-

scribe all necessary rules, forms and orders as to procedure and for carrying the Act into effect, is plainly limited to provisions for the execution of the Act itself, and *does not authorize additions* to its *substantive* provisions. *West Co.* v. *Lea,* 174 U. S. 590, 599, 19 S. Ct. 836, 43 L. Ed. 1098. And see *Orcutt Co.* v. *Green,* 204 U. S. 96, 102, 27 S. Ct. 195, 51 L. Ed. 390." (Our emphasis).

Meek v. *Centre County Banking Co.* (1925) 268 U. S. 426, 434, 45 S. Ct. 560, 563; 69 L. Ed. 1028.

"These rules were but intended to execute the act, and *not to add* to its provisions by making that which the *statute* treats in *some* cases as *immaterial* a *material* fact in *every* case. Therefore, though the rules and forms in bankruptcy provide for an issue as to solvency in cases of involuntary bankruptcy, where by the statute such issue becomes *irrelevant,* because the *particular* act relied on in a *given case* conclusively imports a right to the adjudication in bankruptcy if the act be established, the allegation of insolvency in the petition becomes superfluous, or, if made, need not be traversed." (Our emphasis).

George M. West Co. v. *Lea* (1899) 174 U. S. 590, 19 S. Ct. 836, 839; 43 L. Ed. 1098.

"These rules, forms and orders are of binding effect upon the courts within the limitation that they do not *add to, subtract* from, or *vary* from the provisions of the National statutory law pertaining to bankruptcy. *West Company* v. *Lea,* 174 U. S. 590, 599, 19 S. Ct. 836, 43 L. Ed. 1098; *Orcutt* v. *Green,* 204 U. S. 96, 102, 27 S. Ct. 195, 51 L. Ed. 390; *Meek* v. *Centre County Banking Co.,* 268 U. S. 426, 434, 45 S. Ct. 560, 69 L. Ed. 1028."

• • •

"The Seventh Circuit Court of Appeals also looked to substance and not to form in holding that where the Bankruptcy *Act* makes *no requirement* that the bankrupt shall itemize or value property claimed as

exempt, although the caption of the official form of schedule makes such suggestion, the form 'is merely *directory,* and not mandatory.' " (Our emphasis).

In re: State Thread Co. (6 Cir., 1942) 126 F. 2d 296, 300, 301.

"One of the *most important matters* in bankruptcy is that the construction of the various statutory regulations of an administrative nature shall be *uniform* over the entire country." (Our emphasis).

In re: Brecher (2. Cir., 1925) 4 F. 2d 1001, 1002.

No Valid Distinction can be Based on the fact that this Libel Occurred after the Trustees were Appointed.

As with many other dicta and confusions, the opinion raises, but seems to base no ruling upon, the point that this libel was published about three months after approval of the petition and appointment of the Trustees. It says the cause was "never owned" by the corporation but was "owned" from the start by the Trustees. But it hastens to avoid basing a decision thereon by saying:

"By *whatever* manner particular assets *may pass* to the trustee, the bankruptcy court has exclusive authority" etc.

R. 88, 210 F. 2d at 912. Appendix, p. 57.

The term "owned" is misleading. The Act vests *title* to *all* assets in the Trustee, as a *trustee* for all persons interested in the estate including the bankrupt or debtor, and upon abandonment the title to the asset passes by operation of law to the bankrupt.

The libel was directed against the corporation's management and business *before* the reorganization proceeding,—not against the Trustees or their operations (R. 15, 20).

In any estate, and particularly here where the trustees were put in possession and operation of the debtor's going business (R. 52-53), there may be conversions of assets from one form to another.

A fire may cause an involuntary conversion by reducing the value of the property and producing in its stead a cause of action on the fire policy, but such a fire *during* the bankruptcy has been held to vest title to the action in the trustee, the same as if it had happened *before* bankruptcy (*Imperial Assn. Co.* v. *Livingston,* 8 Cir. 1931, 49 F. 2d 745, 749). The same was held to be true when the bankrupt's automobile was stolen *during* the bankruptcy:

> "The plaintiff, after his appointment and qualification as trustee, could sue for *damages* to the *property* of the bankrupt estate occurring *after* adjudication and both *before* and *after* his qualification as trustee. *Arnold* v. *Horrigan* (C.C.A.) 238 F. 39; *Mueller* v. *Nugent,* 184 U.S. 1, 22 S. Ct. 269, 46 L. Ed. 405, *Goodnough* v. *Galloway,* 48 Ar. 239, 84 P. 1049."
>
> *Derby* v. *Newton* (1933) 142 Or. 427, 20 P. 2d 439, 440, point 4.

The same would be equally true of a tort action against a wrongdoer who caused such a fire. It should also be true of an intangible damage to the debtor's assets by this tort. It cannot be doubted that if the trustee failed to sue on the action on the fire policy and abandoned it because it was too burdensome or expensive for him to maintain, it would revert to the bankrupt or debtor who could sue on it in his own name.

The Court of Appeals' opinion assumes that this tort was suable, either by Trustee, or, if the plaintiff had performed the allegedly necessary requirement of getting a court order to produce an abandonment, then it would be suable by the corporation or the plaintiff on its behalf.

In the following case a corporation had been libeled and had sued. It later went into reorganization and the trustee took over the suit. The estate lacked funds to carry on the litigation, so the creditors devised a plan whereby they would assign 50% of their claims against the bankrupt to any person who would furnish money to carry on the suit. It was held that the defendant had no right to complain of this arrangement.

In re: New York Woman, Inc. (D.C. S.D. N.Y. 1940) 34 F. Supp. 831, 832

Bankrupt's Right to Maintain Action.

As against a contention that a bankrupt corporation's tort action against its directors for damages belonged to the trustee, and a motion to dismiss the complaint on that ground, the court said in the following case:

> "The trustee became *vested* by operation of law with title to the property of the bankrupt corporation as of the date of adjudication. Should the *trustee,* however, *elect to abandon* the claim in suit, the bankrupt *corporation,* and through it in a representative capacity the plaintiff and the cross-complainant, *may continue the litigation. Johnson* v. *Collier,* 222 U. S. 538, 32 S. Ct. 104, 56 L. Ed. 306." (Our emphasis).
>
> *Robertson* v. *Schoonmaker* (1935) 158 Mis. 627 285 N.Y.S. 204, 232, par. 23

To like effect:

> "This right of action of the corporation against the directors passed to the trustee in bankruptcy. The trustee might have *declined* to accept it. If such election had been made, the bankrupt *could assert title thereto.* If it in turn did not elect to proceed to enforce it, the stockholder might maintain *its* action." (Our emphasis.)
>
> *Stephan* v. *Merchants Collateral Corporation* (1931) 256 N. Y. 418, 176 N. E. 824, 825, point 10

The following case, cited in the opinion below, is directly against the defendant so far as applicable. A stockholder's derivative action (really a claim) was pending when his corporation went into a reorganization proceeding. The District Court and Circuit Court of Appeals made the same ruling as here:

> "The Circuit Court of Appeals held that a stockholders' derivative suit commenced *before* the corporation's petition under § 77 had been approved could not be continued there *without permission* of the reorganization court. It relied on the provisions of § 77 which gave the reorganizing court *exclusive jurisdiction* of the *debtor* and its *property* and which give a trustee appointed in those proceedings the title and powers of other bankruptcy trustees." (Our emphasis).
>
> *Meyer* v. *Fleming* (1946) 327 U.S. 161, 163 66 S. Ct. 382, 384, 90 L. Ed. 595

But the Supreme Court, holding that the derivative action could proceed on behalf of the debtor *until* and *unless* the trustee *elected* to *take* the asset *into the estate,* said:

> "As stated in *Johnson* v. *Collier, supra,* 222 U.S. page 540, 32 S. Ct. page 105, 56 L. Ed. 306:
>
> 'If, because of the disproportionate expense, or uncertainty as to the result, the *trustee* neither sues nor intervenes, *there is no reason why the bankrupt himself should not continue the litigation.* • • • *If the trustee will not sue and the bankrupt cannot sue, it might result in the bankrupt's debtor being discharged of an actual liability.'* • • •
>
> "We see no reason why there should be a different rule in the case of *stockholders' derivative suits.* They are likewise suits to enforce a *corporate claim.* They are one of the remedies which equity designed for those situations where the management through fraud, neglect of duty *or other cause* declines to take the proper and necessary steps to assert the rights which the corporation has. The stockholders are then allowed to take the initiative and institute the suit which

the *management* should have started had it performed its duty. The corporation is a *necessary party. City of Davenport* v. *Dows,* 18 Wall. 626, 21 L. Ed. 938. *Hence,* it is joined as a *defendant.* But it is only *nominally a defendant,* since any judgment obtained against the *real defendant* runs in *its* favor. The reasons of policy for holding that ordinary suits to enforce a corporate claim are *not abated* when the corporation is adjudged a bankrupt or when a receiver is appointed are equally applicable here." (Our emphasis).

Meyer v. *Fleming* (1946) 327 U.S. 161, 166-167, 66 S. Ct. 382, 385-386, 90 L. Ed. 595

Misapplied Doctrines in the Opinions Below.

The last quoted case, plus the abandonment cases, illustrate *three successive types of situation,* each having different applicable doctrines and reasons therefor. Failure to recognize these distinctions seems to be the cause of the confusion in the opinions below, namely:

(1) An action pending by or on behalf of the bankrupt at the start of the bankruptcy or reorganization proceeding may be continued *until* and *unless* the trustee elects to *take* this asset *into the estate.*

See quotation from *Meyer* v. *Fleming,* 327 U.S. 161, 166-167, *supra*

(2) If no action is filed prior to the bankruptcy or reorganization proceeding, then the cause of action is deemed to *vest* in the trustee at the beginning of the proceeding along with other assets *by operation of law.* So long as the cause of action *remains an asset of the estate,* neither the bankrupt or anyone else can deal with it or sue upon it *without the consent of the bankruptcy court*:

"For it (court) has exclusive authority to determine how causes of action which *have become a part of the bankruptcy estate* shall be enforced".

Meyer v. *Fleming* (1946) 327 U. S. 161, 169 66 S. Ct. 382, 387

(3) *If* and *when* the cause of action *passes out* of the estate and title vests in the bankrupt or debtor by the trustee's *abandonment* of it, then the bankrupt or debtor, or stockholder on its behalf, may bring and prosecute the action, as shown in the abandonment cases previously cited. Further, in an abandonment situation, the title has passed irrevocably out of the estate and there is no possibility of the trustee assuming control of the action as in situation No. 1, *supra.*

The defendant, in order to serve its own purpose of using the alleged rights of the Trustee and Bankruptcy Court as a shield for itself, has urged from the start as the first (and only argued) grounds of its motion to dismiss, the doctrine and authorities applicable to situation No. 2, *supra* (R. 48). Both courts below have in confusion and error written those doctrines into their opinions. This resulted in the District Court's opinion holding that there cannot be any such thing as abandonment without a court order as a general proposition of law (R. 70).

The Court of Appeals' opinion injects this (No. 2) doctrine into its ruling on the motion to remand:

R. 88, 210 F. 2d at p. 913, point 6. Appendix, 56-58.

Then on the motion to dismiss, the Court of Appeals' opinion recognizes the general doctrine of abandonment but gets back to this same (No. 2) doctrine by misapplying *local Bankruptcy Rule* 19 as requiring an order of court to produce any abandonment.

R. 89-91, 210 F. 2d, 913-914. Appendix, pp. 59-61.

The Illinois Cases.

A collateral matter mentioned in the opinion, which needs comment only to avoid confusion, is:

Plaintiff filed these three cases in the Indiana state court first. Then, pressed by the statute of limitations and possible difficulties of serving summons, plaintiff filed similar complaints the next day in the Illinois state court. As stated in the opinion, the *Esquire* case there has been dismissed without prejudice, the *Reader's Digest* case is pending inactive, and the *Crowell-Collier* was dismissed with prejudice, resulting in an appeal and an opinion of the Illinois Appellate Court, *Schmidt v. Crowell-Collier Publishing Company* (1953) 349 Ill. App. 229, 110 N.E. 2d 464, petition for leave to appeal denied, 414 Ill. 628. That decision is not involved here, because the defendant never attempted to base any issue on it in the District Court by any kind of motion or pleading, although the Illinois state court dismissal occurred a year before the District Court decision and the Illinois Appellate Court's opinion had come out a month before the District Court's decision. Instead the defendant merely furnished the District Court a copy of that opinion as a precedent and it was so treated in the District Court's opinion. (R. 70). Subsequently when this appeal was nearly ready for argument in the Court of Appeals, defendant sought to raise the issue of *res adjudicata* for the first time in that court by filing its motion to affirm, based on the Illinois opinion. This was resisted by us on the ground that such affirmative defenses cannot be raised for the first time on appeal, plus the fact that the Illinois opinion on its face decides only questions of *remedy* in the Illinois court, namely: What are "the conditions precedent to the institution of a stockholder's

derivative suit" in Illinois, and bar of the remedy by the Illinois one-year statute of limitations (110 N.E. 2d at p. 466, points 1 and 4) which, when the time comes, can be demonstrated to be not *res adjudicata* on Indiana's remedies in her own courts. (50 C.J.S., Judgments, pages 66-67, notes 9-11).

The only significance of the Illinois Appellate Court decision in this case is that that court, which handles relatively few bankruptcy questions compared to the federal courts, wrote this erroneous and misapplied doctrine regarding necessity of an order for abandonment into its opinion, which has been followed with resulting error and confusion in the two opinions below,—hence, the need for the Supreme Court to straighten out the confusion and get the doctrine of abandonment by bankruptcy trustees back on the track.

Outside Wrongdoer not Permitted to Assert Trustee's Title for its own Defense.

The prospect, which defendants always see in this type of case, for an easy escape by setting up the trustee's alleged title, while the trustee remains passive, causes this kind of attempted defense to arise frequently, and the attempt appears to have been rejected in every case. It was attempted by the defendant in *Meyer* v. *Fleming*, 327 U.S. 161 at p. 163, *supra*, and was successful in the lower courts but was rejected by this Court (pp. 166-167).

Again, in the following case, the defendant sought and obtained dismissal on the ground that the assets sued upon *had not been abandoned* but were still *vested* in the *trustee*. The Court of Appeals rejected this defense and reversed, saying:

> "For the Supreme Court has held that when the trustee in bankruptcy abandons an asset, he is to be

treated as never having had title to it, the abandonment is said to relate back, so that the title stands as if no assignment had been made. • • • the trustee never had occasion to proceed and the right is viewed *not as having lapsed in favor of the claimed wrongdoer*, but as remaining in the bankrupt."

Rosenblum v. *Dingfelder* (2 Cir. 1940) 111 F. 2d 406, 409, point 12.

In the following leading case where a patent, and the cause of action for its infringement during bankruptcy, had been abandoned by the trustee without an order, and the wrongdoing infringer when sued by the bankrupt's vendee, sought to set up a right of the trustee to claim the patent, the court said:

"*But it does not lie in the mouth of an alleged infringer* to set up the right of the assignee (trustee) as against a title from the bankrupt acquired with the consent of such assignee."

Sessions v. *Romadka* (1892) 145 U. S. 29, 36 L. Ed. 609, 613, 12 S. Ct. 799, 801.

In a similar situation, the Court of Appeals for the Sixth Circuit said:

"The suggestion that there might be some possible outside interest is one which *a court of equity ought not to accept from a mere trespasser* for the sake of enabling the trespasser to avoid the results of his unlawful action."

Mills Novelty Co. v. *Monarch Tool & Mfg. Co.* (6 Cir. 1931) 49 F. 2d, 28, 32.

This just and sensible doctrine of the above cases has been entirely ignored in the opinions below, with the result that those courts, at the behest of this outside wrongdoer, have set up alleged rights of the trustee which would be erroneous even if granted to him and which are still more so when granted to this outsider and used for the purpose

of *distorting* the principles of *diversity* jurisdiction and *abandonment* of assets by bankruptcy trustees.

WHEREFORE, petitioner respectfully prays that this Honorable Court may grant its writ of certiorari to bring up and review this case, and for all further just and proper relief.

JAY E. DARLINGTON
Attorney for Petitioner

DISTRICT COURT'S OPINION.

Plaintiff's motion to remand is based on the claim that there is a lack of diversity. He contends that Tucker Corporation must be alligned on the plaintiff's side. This would destroy diversity. The question of allignment does not arise however if Tucker Corporation is not a necessary party because only indispensable parties need be regarded in testing diversity. *Salem Trust Co.* v. *Manufacturers' Finance Co.*, 264 U. S. 182.

The complaint shows that Crowell-Collier Publishing Company and Tucker Corporation are Delaware corporations and that the plaintiff is a citizen of Illinois. The complaint shows also that Tucker Corporation is the debtor in a proceeding under Chapter X of the Bankruptcy Act; that on March 3, 1949, a voluntary petition for reorganization was approved and trustees were appointed in the United States District Court for the Northern District of Illinois.

The plaintiff alleges that the cause of action was abandoned by the surviving trustee and thereby has reverted to the corporation. In his complaint he also says:

> "13. Tucker Corporation has been named a formal defendant in this action to meet the formal requirement that the stockholder's corporation be made a party plaintiff or defendant in a stockholder's action. It being impossible to have the corporation join as a party plaintiff for the reasons aforesaid, it has been named as a formal defendant. However, as appears on the face of this complaint, no money judgment or other relief is sought respecting it or any of its property, save only the preservation and enforcement of this cause of action."

It is the settled law that in a derivative shareholders action the corporation is a necessary party. *Davenport* v. *Dows*, 85 U.S. 626.

There are, however, exceptions. It has been held that a corporation is not a necessary party to such actions if it has been dissolved or is defunct. *McClean* v. *Bradley,* 282 Fed. 1011; *Weinert* v. *Kinkel,* 71 N.E. 2d 445.

Another exception arises when a corporation is placed in receivership. The corporation's property is in *custia legis.* Consequently, the right to enforce a stockholder's derivative action and "all other rights of property of the corporation vests in the receiver, and he is the party to bring suit, and, if he does not himself sue, should properly be made a defendant to any suit by stockholders in the right of the corporation" *Porter* v. *Sabin,* 149 U.S. 473, 478. It follows that under such circumstances the corporation is not a necessary party but is merely nominal.

This reasoning is equally applicable in a bankruptcy proceeding, where, under § 186 of the Bankruptcy Act, the reorganization trustee is vested with complete legal title to all the property, including rights of action, of the debtor. *Gochenour* v. *Cleveland Terminals Bldg. Co.,* 118 F. 2d 89. The conclusion that the debtor corporation is not a necessary party is inescapable when considered in connection with the settled rule that the bankruptcy court "has exclusive authority to determine how causes of action which have become a part of the bankruptcy estate shall be enforced." *Meyer* v. *Fleming,* 327 U.S. 161.

Plaintiff's contention that this alleged cause of action was abandoned by the trustee cannot be sustained. The Appellate Court of Illinois on February 2, 1953, in *Schmidt* v. *Crowell-Collier Publishing Company, et al.,* 110 N.E. 2d. 464, dealt with this identical contention and concluded that there had been no abandonment by the trustee through any order of court. It also held that the stockholder's rem-

edy lies within the bankruptcy proceeding and not by his unauthorized suit in behalf of the corporation. The Court said:

> "If the assets of the corporation have passed to a trustee in bankruptcy the stockholder must request the trustee to institute suit and, if he declines, petition the court before whom the proceeding is pending to direct the trustee to bring suit or authorize the stockholder to sue."

The holding of the Illinois Appellate Court is adopted as is the holding in *Gochenour* v. *George & Francis Ball Foundation et al.*, 35 F. Supp. 508, where a similar contention was made.

It is concluded that the plaintiff's motion to remand should be denied.

The defendant Crowell-Collier Publishing Company's motion to dismiss this action must be granted. Much of what has been said in connection with the motion to remand is applicable to this motion. *Meyer* v. *Fleming*, and *Gochenour* v. *Cleveland Terminal Bldg. Co.*, supra, lay down the rule that the bankruptcy court alone has the right to determine whether a cause of action belonging to the corporation should be instituted and which cause of action, except for the bankruptcy proceeding, might have been the subject of a shareholder's derivative suit. Cf. *Porter* v. *Sabin, supra.* Since the bankruptcy court did not authorize the instant action, it must be dismissed.

COURT OF APPEALS' OPINION.

Before MAJOR, *Chief Judge*, FINNEGAN and SWAIM, *Circuit Judges.*

SWAIM, *Circuit Judge.* These cases, three in number, are closely related in subject matter, and we are combining their disposition into a single opinion. The appeal in each case is from an order of the District Court dismissing the complaint which attempted to allege a stockholder's derivative action for libel. The plaintiff in each case is George Schmidt, a resident of Illinois. He filed suits on behalf of the Tucker Corporation, organized under the laws of Delaware, against The Crowell-Collier Publishing Company, a Delaware corporation; The Reader's Digest Association, Inc., a New York corporation; and Esquire, Inc., a Delaware corporation.

The actions were commenced in the Circuit Court of Lake County, Indiana, and from there were removed, on the motions of the defendants, to the United States District Court for the Northern District of Indiana. The plaintiff filed motions to remand in the *Crowell-Collier* and *Esquire* cases on the ground that there was no diversity, but these motions were denied. The Tucker Corporation was served with process in each case by service upon its Executive Vice President, but it has entered no appearance of any kind.

The complaints are substantially identical. In substance they allege the following: The plaintiff is the owner of 1,000 shares of capital stock of the Tucker Corporation. This company was organized to manufacture and sell a radically new, rear-engined automobile. A large plant was leased and equipped with machinery for the mass production of this car, and several million dollars were spent on engineering, development and nation-wide advertising. In

March of 1949 the United States District Court for the Northern District of Illinois, finding that the company was unable to pay its debts as they matured, approved a petition for reorganization of the corporation under Chapter X of the Bankruptcy Act. Trustees were duly appointed to take charge of the assets and manage the affairs of the corporation. Subsequently during the year 1949, there appeared in Colliers, The Reader's Digest and Coronet magazines, articles regarding the Tucker Corporation and its activities. These articles conveyed to the reading public the idea that the corporation's management in the conduct of its business had been guilty of fraud, corruption and crime; that the company's product was ridiculous in character, unworkable, and tainted and characterized by fraud; and that the corporation had failed in its purpose and was unfit for business patronage or financial credit. Such representations were false and libelous, and, as a result of them, the company's business was injured, its goodwill was destroyed, and its product was held up to contempt and ridicule. The company has, therefore, been unable to obtain credit, to raise new capital, or to reorganize and proceed with the manufacture and sale of its product. The proceedings under Chapter X of the Bankruptcy Act are still pending, no reorganization plan has been approved, and there is little likelihood that one will be. The surviving trustee, meanwhile, has made no attempt to schedule or to enforce these causes of action for libel as an asset of the estate. In February of 1951, the plaintiff's attorney, on behalf of stockholders of the corporation, stated to the officially appointed and authorized counsel for the trustee that he considered this cause of action to be meritorious and of value to the corporation. He reminded counsel for the trustee that the period of limitation was about to expire, and requested that he, the counsel for the trustee, prosecute the action before it became outlawed.

In response, "counsel for the trustee stated in substance that he had been considering this matter and had reached the conclusion that he would not do so, and that he considered this cause of action to be non-existent and not an asset of the corporation estate." Thereafter, on February 23, 1951, the plaintiff's attorney, by letter, notified counsel for the trustee that he intended to file this stockholder's suit on the cause of action for libel, "as an asset which had been abandoned in fact and law by the trustee and which had thereby reverted to the corporation," and he asked to be notified to the contrary if this were not the position of the trustee and of the court in charge of the reorganization proceeding. Copies of this letter were sent to the trustee and to the court for their information and notice. Both the trustee and the court remained silent, "thereby acquiescing in and ratifying said abandonment of this cause of action to the corporation." On February 24, 1951, the plaintiff's attorney, by letter, notified the corporation's president, three vice-presidents, and a majority of the board of directors of the cause of action for libel and its abandonment as an asset of the estate, and he demanded that they cause the corporation to sue on the cause before it became outlawed. They have taken no action in the matter, and as the plaintiff is informed and believes, the corporate management and board of directors are incapable of taking any action, "because of the fact that they are widely scattered and have not met for a long time and are not likely to meet for the conduct of this or other corporate affairs, due to the aforesaid destruction of the corporation's business." The plaintiff has exhausted all other means to have this action filed before it becomes lost to the corporation. Accordingly, it was necessary that this stockholder's suit be filed in order to preserve the cause of action. Since it was not possible to have the corporation join as a party plaintiff for the reasons stated,

"it has been named as a formal defendant." However, the only relief sought with respect to the corporation is the preservation and enforcement of the cause of action for libel.

The day after these complaints were filed in the Circuit Court of Lake County, Indiana, the plaintiff filed identical actions in the Superior Court of Cook County, Illinois. In the latter court the *Reader's Digest* case is still pending, the suit against Esquire was dismissed by stipulation of both sides without prejudice, and the *Crowell-Collier* case was ordered dismissed with prejudice. This latter order was affirmed by the Illinois Appellate Court, *Schmidt* v. *Crowell-Collier Publishing Co.*, 349 Ill. App. 229. In the view which we take of the cases before us, we need not consider whether the Illinois judgment in the *Crowell-Collier* case should be considered *res adjudicata.*

The *Crowell-Collier* case was dismissed by the District Court because the action was not authorized by the court having charge of the Chapter X proceedings. This was held to be essential since, in the view of the District Court, the complaint did not contain allegations sufficient to show an abandonment of the cause of action by the trustee. In the *Reader's Digest* and *Esquire* cases, the complaints were dismissed on the ground that the court had no jurisdiction over those corporations for the reason that they were not doing business in Indiana and were not, therefore, amenable to suit there.

We consider first the ruling of the District Court in the *Crowell-Collier* case, and we conclude that they were correct. The plaintiff's motion to remand was based principally on the theory that, although the Tucker Corporation was named as a defendant in the complaint, for the purpose of testing diversity jurisdiction it should have been realigned as a plaintiff in accordance with its actual interest

in the controversy. Thus, diversity would have been destroyed by the presence of a Delaware corporation on each side of the case. We note that in stockholders' derivative actions it has not been the practice to realign the corporation as a plaintiff, although the action is one to enforce a corporate claim and any recovery is for the benefit of the corporation. *Koster* v. *Lumbermens Mutual Co.*, 330 U. S. 518; *Meyer* v. *Fleming*, 327 U. S. 161; *Venner* v. *Great Northern Railway*, 209 U. S. 24; *Doctor* v. *Harrington*, 196 U. S. 579; *Lavin* v. *Lavin*, 2 Cir., 182 F. 2d 870. The corporation is left a defendant on the theory that it is controlled by antagonistic hands. *Koster* v. *Lumbermens Mutual Co.*, 330 U. S. 518. It does not seem that a different rule of alignment applies when, as in this case, there is no indication that the refusal by the corporate management to sue results from fraudulent or other improper motives. See *Ashwander* v. *Valley Authority*, 297 U. S. 288; *Hill* v. *Wallace*, 259 U. S. 44; *Del. & Hud. Co.* v. *Albany & Susquehanna*, 213 U. S. 435; *Chicago* v. *Mills*, 204 U. S. 321. *Cf. Groel* v. *United Electric Co.*, 132 Fed. 252. However, we need not consider further the plaintiff's theory of alignment, for we think the District Court ruled correctly that under the circumstances of this case the citizenship of the Tucker Corporation is immaterial for the purpose of testing diversity.

Ordinarily, it is true, the corporation is an indispensable party to a stockholder's derivative action, since the claim asserted belongs to the corporation and any judgment rendered must conclude the corporation. *Price* v. *Gurney*, 324 U. S. 100; *City of Davenport* v. *Dows*, 18 Wall. 626, 627; *Greenberg* v. *Gianinni*, 2 Cir., 140 F. 2d 550, 554. However, upon adjudication in bankruptcy or approval of a petition for reorganization under Chapter X, property of the debtor vests in the trustee and is thereafter subject

to the exclusive jurisdiction of the Bankruptcy Court. 11 U. S. C. A., Secs. 110, 586; *Isaacs* v. *Hobbs Tie and Timber Co.*, 282 U. S. 734; *Gochenour* v. *Cleveland Terminal Bldg. Co.*, 6 Cir., 118 F. 2d 89; *Lockhart* v. *Garden City Bank & Trust Co.*, 2 Cir., 116 F. 2d 658. The District Court in this Chapter X proceeding, in the order approving the petition for reorganization and appointing trustees of the estate of the Tucker Corporation, therefore, property directed the trustees to institute and prosecute such actions as in their judgment might be necessary for the "protection, maintenance and preservation of the property and assets" of the corporation. It may be noted that since the alleged libels here involved occurred subsequent to the appointment of the trustees, the causes of action were never owned by the Tucker Corporation but were vested in the trustees immediately upon the publication of the libels. But in whatever manner particular assets may pass to the trustee, the bankruptcy court "has exclusive authority to determine how causes of action which have become a part of the bankruptcy estate shall be enforced." *Meyer* v. *Fleming*, 327 U. S. 161, 169. The Supreme Court in *Porter* v. *Sabin*, 149 U. S. 473, applied these principles of law where the corporation in whose behalf the claim was asserted was in receivership, an analogous situation. After referring to the ordinary rule that the corporation necessarily is a party to a stockholder's derivative action, the court stated (page 478): "If the corporation becomes insolvent, and a receiver of all its estate and effects is appointed by a court of competent jurisdiction, the right to enforce this and all other rights of property of the corporation vests in the receiver, and he is the proper party to bring suit, and, if he does not himself sue, should properly be made a defendant to any suit by stockholders in the right of the corporation." See *Coyle* v. *Skirvin*, 10 Cir., 124 F. 2d 934; *Klein* v. *Peter*, 284 Fed. 797.

So in this case the cause of action for libel, assuming such a claim existed, was owned not by the Tucker Corporation but rather by the trustee, subject to the exclusive control of the court in which the Chapter X proceedings had been filed. Any judgment respecting such a claim, to be final and binding, necessarily would have to conclude the trustee. Under these circumstances, we think the corporation could rightly be disregarded as a party to the suit. Its citizenship was not, therefore, revelant to the question of diversity jurisdiction.

But in this case the complaint stated no claim upon which relief could be granted. As we have already shown, the power to authorize the filing and prosecution of this cause of action was exclusive with the reorganization court, and the responsibility for its prosecution lay with the trustee. Upon the refusal of the trustee to act, the plaintiff could have petitioned the reorganization court to compel the trustee to bring suit or to authorize the plaintiff to sue, naming the trustee as a defendant. Without such authorization the plaintiff stockholder may not maintain this derivative acton. *Meyer* v. *Fleming*, 327 U. S. 161; *Glenny* v. *Langdon*, 98 U. S. 20; *Zeleznik* v. *Grand Riviera Theater Co.*, 6 Cir., 128 F. 2d 533; *Geckeaour* v. *Cleveland Terminals Building Co.*, 6 Cir., 118 F. 2d 89.

The contention that here the trustee had in fact abandoned the cause of action, with the result that title to the asset was revested in the corporation, is without merit. It is true, as a general principal of law, that a trustee in bankruptcy may abandon onerous or unprofitable assets. *Dushane* v. *Bell*, 161 U. S. 513; *In Re Thomas*, 7 Cir., 204 F. 2d 788; *In Re Malcom*, 48 F. Supp. 675. It is likewise certain that title to abandoned assets thereupon revests in the bankrupt. *Brown* v. *O'Keefe*, 300 U. S. 598; *In Re*

Webb, 4 Cir., 54 F. 2d 1065. It is not so certain just what action by the trustee is necessary to constitute an abandonment. There is no universally applied formula which he is required to follow, and whether abandonment has occurred in a particular case is usually a question of fact. *Stonelind Oil & Gas Co.* v. *Logan*, 5 Cir., 92 F. 2d 28. The trustee may expressly declare his intent to abandon, *Socious* v. *Hernadez*, 145 U. S. 23, while in some cases a mere failure by the trustee to administer property of which he has knowledge has been held sufficient. *Sparhawk* v. *Yerkes*, 142 U. S. 1; *Mills Novelty Co.* v. *Monarch Tool & Mfg. Co.*, 6 Cir., 49 F. 2d 28. See Judge Lindley's extensive discussion in *In Re Malcom*, 40 F. Supp. 675.

It is generally assumed that an order of the bankruptcy court is not requisite to the abandonment of property by the trustee. However, it is essential to recognize that it is the court which administers the estate through its officer, the trustee, who is always subject to the court's control. The authority of the court is paramount and exclusive; it "has the final word." *In Re Hamerstrom*, 2 Cir., 93 F. 2d 187, 188. General Order 36 of the General Orders in Bankruptcy states that "each court of bankruptcy may from time to time make and amend rules governing its practice in proceedings under the Act * * *." 11 U. S. C. A., foll. Sec. 53. A rule of the bankruptcy court so authorized and adopted has the force of law. *Weil* v. *Neary*, 278 U.S. 160; *Rio Grande Irrigation Co.* v. *Gildersleeve*, 174 U. S. 600; *In Re G. W. Gimmini, Inc.*, 2 Cir., 90 F. 2d 445; *Cf. Washington-Southern Co.* v. *Baltimore Co.*, 263 U. S. 629. The District Court for the Northern District of Illinois has adopted a rule, Bankruptcy Rule 19, which provides, in part: "The trustee may, upon approval by the court, abandon any property of the bankrupt if burdensome or of no net realizable value." (Our

emphasis.) The Bankruptcy Court, in the exercise of its paramount authority, could adopt this rule as a governing requirement in the administration of bankruptcy matters in that court. Thus, we think it clear, in the instant case, that the trustee could not abandon the claim for libel without securing the court's approval.

But the plaintiff contends that the requiring of a formal petition, notice, and hearing in order to secure the approval of the court for the abandonment of assets in a bankruptcy matter would unduly hinder the practical administration of the assets, and he suggests that Rule 19 merely contemplates that the trustee will act generally within the scope of his authority and with the informal approval of the court.

The plaintiff relies heavily on the opinion of Judge Lindley in *In Re Malcom*, 48 F. Supp. 675, 679, which referred to abandonment after notice and hearing as being the "better practice," but held that the abandonment in that case was completed without such a notice and hearing. But in that case Judge Lindley was considering an abandonment of assets in a bankruptcy matter ten years after the estate had been closed. There the assets in question were investigated by the trustee and found to be encumbered for more than their value. The trustee, therefore, never took possession of those assets nor administered on them and the question arose in a proceeding to reopen the bankruptcy in order to remove an alleged cloud on the title of the then owner, which was alleged to exist because of the fact that there had been no petition and hearing concerning their abandonment.

In view of the law which we have set out above, it is clear that in a bankruptcy proceeding in the Northern District of Illinois, where this proceeding was pending,

the trustee could abandon an asset of the debtor only with the approval of the court, and we cannot agree with the plaintiff's contention that the court ratified the abandonment of these causes of action to the debtor corporation by the trustee, by merely remaining silent after receiving copies of the letter which plaintiff had written to an attorney for the trustee stating that plaintiff intended to file these derivative actions on the theory that they were assets which the trustee had "abandoned in fact and in law," and in which letter the plaintiff asked "to be notified to the contrary if such was not the position of the trustee and the court having charge of said reorganization proceeding."

The court in which this bankruptcy proceeding was pending was, of course, a court of record. It acts only through its orders which are made of record. It could approve the abandonment of these causes of action only by an order duly entered. Since no such order was entered the court did not approve the abandonment. *Schmidt* v. *Crowell-Collier Publishing Co.*, 349 Ill. App. 229, 234.

Our conclusions in the *Crowell-Collier* case resolve the question of diversity in the *Esquire* case. No question of diversity was raised in the *Reader's Digest* case. The remaining question in the *Reader's Digest* and *Esquire* cases is whether those complaints were rightly dismissed for lack of personal jurisdiction. We conclude that they were.

The plaintiff attempted to obtain service of process upon The Reader's Digest Association, Inc., and Esquire, Inc., by serving the Secretary of State of Indiana, in accordance with Burns Ind. Stats. Ann., Sec. 25-316 (1948 Repl.). That statute provides, in part: "The engaging in any transaction or the doing of any business in this state by

any foreign corporation not licensed nor admitted to do business in this state * * * shall be deemed equivalent to an appointment by such foreign corporation of the secretary of state * * * to be the true and lawful attorney and agent of such foreign corporation upon whom may be served all lawful processes * * * in any action or proceeding against such foreign corporation arising or growing out of, directly or indirectly, any act or thing done by such corporation within the state of Indiana."

With respect, first, to the *Reader's Digest* case, affidavits considered by the District Court reveal the following pertinent information: The Reader's Digest Association, Inc., is a corporation foreign to the State of Indiana, and it is not licensed nor admitted to do business there. The Reader's Digest magazine is printed and published outside the state, and is sent to Indiana subscribers by mail. Newsstands and stores in Indiana which sell the magazine purchase their copies from local wholesalers, whose copies are obtained from a New York wholesaling corporation to which Reader's Digest sells its entire store and newsstand supply. Reader's Digest has no office in Indiana of any kind. It does, at times, solicit through its magazine so-called "community representatives" to obtain subscriptions. The advertisement urges the reader to supplement his regular income through liberal commissions easily obtained by acting as a community representative in his spare time. Anyone answering the advertisement is sent the materials necessary to solicit subscriptions, including an order book. The solicitor collects the price of the subscription and remits this to the defendant in New York after deducting his commission. He is furnished "Subscribers Receipt" forms with spaces for the subscriber's name, the amount paid, and his signature as

"Representative." He is also furnished with "Correction" forms for recording complaints, changes of address, and the like.

It is not contended that Reader's Digest was doing business in Indiana through the store and newsstand sales of its magazine, nor through the mailing of its magazine to Indiana subscribers. It is only the activity of the so-called community representatives which, it is said, constitutes such "doing business" as to make Reader's Digest amenable to service of process in Indiana.

Considerable reliance is placed on the doctrine of *International Shoe Co.* v. *Washington*, 326 U. S. 310, which concerned the question of how much activity by a foreign corporation in a state is necessary to give that state the right to subject the foreign corporation to suit in the courts of that state without violating the due process clause of the Constitution. However, we think it is well to point out that the initial question in a case such as the instant one is not whether Indiana could, consistent with due process, assert jurisdiction over Reader's Digest. Rather, the question we should first consider is whether Indiana has chosen to assert jurisdiction under circumstances such as are present in this case. Only if the second point is answered affirmatively is there occasion to consider the first. This is so for the reason that Indiana may not choose to "extend to suitors access to its courts against foreign corporations as amply as it has power to do under the Constitution." *Bomze* v. *Nardis Sportswear*, 2 Cir., 165 F. 2d 33, 35. See also *Partins* v. *Michaels Art Bronze Co.*, 3 Cir., 202 F. 2d 544; *Rosenthal* v. *Frankfort Distillers Corp.*, 5 Cir., 193 F. 2d 137; *Pulson* v. *American Rolling Mill Co.*, 1 Cir., 170 F. 2d 193.

Following this approach, we would first decide whether the Indiana statute, passed in 1939, contemplates service on foreign corporations under circumstances such as we have in this case. The Supreme Court of Indiana had earlier held, consistently with the established rule, that mere solicitation of business in the state by an agent did not subject a foreign corporation to local jurisdiction. *Mutual Mfg. Co.* v. *Alspaugh,* 174 Ind. 381. See *Philadelphia & Reading R. Co.* v. *McKibbin,* 243 U. S. 264; *Green* v. *Chicago, B. & Q. R. Co.,* 205 U. S. 530. We have not been cited to, nor have we found, any reported decisions in the Indiana courts construing the statute involved in the instant case. However, we do not think it necessary to decide whether or not the Indiana statute is as broad as the *International Shoe* doctrine would permit. Whether the question is one of due process, or state law, we think the District Court correctly decided the question on the principles announced in *Cannon* v. *Time,* 4 Cir., 115 F. 2d 423. In that case the foreign corporation, Time, Inc., delivered its magazines to the Richmond News Company, the local branch of a wholesaling concern, which in turn sold to local newsstands and stores. In addition, the Richmond News Company solicited and collected for subscriptions, and based upon this activity was the contention that Time was doing such business in the state as to be subject to local jurisdiction. The court held, however, that the News Company was an independent contractor doing business for his own account and not as an agent of Time. Therefore, Time was not doing business within the state and was not amenable to suit there.

We can see little difference in principle between that situation and the one which confronts us here. There are factual distinctions, it is true, but we do not think they are decisive. The Reader's Digest community representa-

tives are under no supervision, direction or control, they conform to no prearranged schedule or routine, they may solicit or not as it suits their opportunity or inclination. Certainly, they are not agents of Reader's Digest within the meaning of all that term implies. They are urged by the defendant to work in their spare time, for their own account, to supplement their income. We think it is inescapable that they be considered as occupying the position of independent contractors.

The question of personal jurisdiction in the *Esquire* case may be quickly disposed of. Affidavits filed with the District Court disclose the following: Esquire, Inc., is a corporation foreign to the State of Indiana and is not licensed nor admitted to do business there. It publishes the Esquire and Coronet magazines, which are available in Indiana either through subscription or at the newsstand. These magazines are printed in Chicago and are mailed directly from there to Indiana subscribers. They are placed on newsstands in Indiana by the Curtis Publishing Company, an independent corporation which purchases the magazines from Esquire and effects distribution through independent wholesale organizations. Esquire has no office of any kind in Indiana, and it has no employees or agents there to gather material for publication, nor to solicit advertising, subscriptions or newsstand sales.

Under these facts, we do not see how it can seriously be contended that Esquire was amenable to suit in Indiana. In the *Reader's Digest* case the plaintiff concedes, as well he must, that something more than this is required to give local jurisdiction. *Cannon* v. *Time,* 4 Cir., 115 F. 2d 423; *Whitaker* v. *Macfadden Publications,* D. C. Cir., 105 F. 2d 44. Obviously, the necessary contacts with the state are absent here.

The plaintiff's attack on the affidavits filed by Reader's Digest and Esquire is without merit. We think they were sufficient, together with the facts shown by the plaintiff's affidavit, to sustain the action of the District Court.

In the view which we have taken of these cases, it is not necessary that we consider any of the other questions raised by the parties.

The judgment of the District Court in each of the three cases is

AFFIRMED.

A true Copy:
Teste:

.....

Clerk of the United States Court of Appeals for the Seventh Circuit.

FILED
JUN 17 1954
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1953.

No. [redacted] 92

GEORGE SCHMIDT,

Petitioner,

vs.

THE CROWELL-COLLIER PUBLISHING COMPANY,

Respondent.

ANSWER TO PETITION FOR WRIT OF CERTIORARI.

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THE BLAKELY PRINTING COMPANY, CHICAGO

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1953.

No. 785.

GEORGE SCHMIDT,

Petitioner,

vs.

THE CROWELL-COLLIER PUBLISHING COMPANY,

Respondent.

ANSWER TO PETITION FOR WRIT OF CERTIORARI.

In 1947 Tucker Corporation advertised "the first completely new car in fifty years." In 1947 and 1948 it raised nearly $26,000,000 in sales of franchises to dealers and in public sale of common stock (R. 44). In 1949 it filed its petition in reorganization bankruptcy in the United States District Court for the Northern District of Illinois. On March 3, 1949, the petition was approved and trustees were appointed who upon that date took over the business and assets (R. 18). The usual injunction prohibited interference by stockholders or others with the exclusive jurisdiction of the bankruptcy court over the debtor, the trustees, and the properties (R. 55-6).

Several months later, the Crowell-Collier Publishing Company published in its June 25, 1949 edition of Collier's an article entitled "The Fantastic Story of the Tucker Car" (R. 20).

On March 1, 1951, the petitioner Schmidt, a citizen and resident of Illinois (R. 3), filed this suit in the circuit court of Lake County, Indiana, against said The Crowell-Collier Publishing Company, a Delaware corporation (R. 13). The suit was based upon the Collier's article and, brought by Schmidt as a stockholder of Tucker Corporation, purported to be *a derivative action for libel.* Tucker Corporation, a Delaware corporation, was joined as "formal defendant" (R. 13, 19). The trustees were not made parties. Schmidt neither obtained nor sought to obtain an order of the bankruptcy court directing the trustees to bring suit, or authorizing Schmidt to bring suit upon behalf of the trustees, or selling, assigning or otherwise attempting to separate the cause of action from the business and assets which it concerned. However, the bankruptcy proceeding was still pending, "with no reorganization plan approved and with slight chance that one will be" (R. 18).

In an attempt to show in Tucker Corporation an ownership of the cause of action, the complaint alleged (R. 19): that there was a conversation between plaintiff's counsel and trustees' counsel wherein the latter said that he would not sue and that he considered this cause of action to be non-existent; that plaintiff's counsel thereupon wrote a letter to trustees' counsel reciting that he intended to file a stockholder's action; in that letter plaintiff's counsel requested that trustees' counsel notify him if the views of trustees' counsel were not shared by the trustees and by the court. The only presentation to the trustees or to the court was that copies of said letter to trustees' counsel were sent to the trustees and to the court. No petition was filed and no order of court was obtained or sought.

Petitioner's theory is that because his counsel thus notified trustees' counsel, and because with copies of a letter he thus informally notified the trustees and the court,

and because thereupon the trustees had taken no action before he himself sued (four months still remained before the Indiana two-year limitations expired), that thereby the cause of action for libel was no longer the trustees' but became the cause of action of the inactive Tucker Corporation, for its stockholders and *free of its creditors* (Court of Appeals Reply Brief, p. 16).

Petitioner's theory further is that although the bankruptcy proceeding was pending that that extraordinary result was accomplished without notice to creditors, without a petition to the bankruptcy court, without paying any consideration, without any assignment attempting to separate the cause of action from business and assets, and without any order of court.

The Crowell-Collier Publishing Company removed the action to the United States District Court for the Northern District of Indiana. The petition for removal alleged (R. 2) as did the complaint (R. 10), that Tucker Corporation was incapable of taking action.

Pursuant to Rule 12b6 of the Rules of Civil Procedure, The Crowell-Collier Publishing Company moved (R. 46) for dismissal of the complaint for failure to state a claim upon which relief can be granted. Schmidt then moved (R. 62) for remand to the State court, claiming that Tucker Corporation (a Delaware corporation) should be aligned as a plaintiff with destruction of diversity of citizenship, inasmuch as The Crowell-Collier Publishing Company was a Delaware corporation.

The court denied the motion to remand, upon the ground that Tucker Corporation was not an indispensable party. The court also sustained the publishing company's motion to dismiss (Opinion of District Court, R. 68; printed in petition for certiorari, p. 40).

Schmidt elected to stand upon his complaint and ap-

pealed. The Court of Appeals sustained the overruling of the motion to remand, upon the ground that the Tucker Corporation was not an indispensable party, and sustained the motion to dismiss the complaint, upon the ground that the cause of action, if any, was not owned by Tucker Corporation but was vested in the trustees who were the indispensable parties (Opinion of Court of Appeals, 210 F. (2d) 909; printed in petition for certiorari, p. 52).

A complaint with the same allegations and with the same plaintiff and against the same defendants had been dismissed by the Illinois courts for failure to state a cause of action. *Schmidt v. The Crowell-Collier Publishing Co.*, 349 Ill. App. 229, 110 N. E. (2d) 464, leave to appeal denied, 414 Ill. 628.

Petitioner's Claim of Error.

Petitioner in this court claims that the District Court for the Northern District of Indiana erred in overruling his motion to remand to the circuit court of Lake County, Indiana.

In Testing Diversity of Citizenship Only Indispensable Parties Are Considered.

In *Salem Trust Co. v. Manufacturer's Finance Co.*, 264 U. S. 182, 190, the Court said:

> "On the question of jurisdiction, an unnecessary and dispensable party will not be considered. *Walden v. Skinner*, 101 U. S. 577, 589; *Bacon v. Rives*, 106 U. S. 99, 104; * * *."

In *Lee v. Lehigh Valley Coal Co.*, 267 U. S. 542, 543, the Court said:

> "When a defendant seeks to remove a suit from a State Court to the District Court, of course he is entitled to contend that a party joined by the plaintiff

> is not a necessary party and therefore does not make the removal impossible by defeating the jurisdiction. *Salem Trust Co.* v. *Manufacturer's Finance Co.*, 264 U. S. 182."

Authorities are legion that "only indispensable parties are considered in determining jurisdiction." *Jones* v. *Box Elder County*, 52 F. (2d) 340, 341 (C. A. 10), cert. den. 285 U. S. 555; *First Trust & Savings Bank* v. *Iowa-Wisc. Bridge Co.*, 98 F. (2d) 416, 419 (C. A. 8), cert. den. 305 U. S. 630; *Colcote* v. *Texas Pac. Coal & Oil Co.*, 157 F. (2d) 216, 218 (C. A. 5), cert. den. 329 U. S. 782.

Petitioner argues (pp. 25-27) that "the corporation is always an indispensable party in a derivative action." Petitioner relies upon cases in which there was no bankruptcy or receivership and in which the corporation owned the cause of action and the plaintiff pursued a real, derivative remedy. The present complaint showed upon its face that the bankruptcy trustees, and not the corporation, owned the cause of action. In fact, the cause of action, if any, arose in the bankruptcy trustees over three months after they took over the business and assets of Tucker Corporation.

Petitioner argues (pp. 25, 27-34) that the District Court improperly went "into the merits of the complaint in deciding the motion to remand."

We quote the District Court's opinion (R. 69; printed in petition for certiorari, p. 49):

> "Plaintiff's motion to remand is based on the claim that there is a lack of diversity. He contends that Tucker Corporation must be aligned on the plaintiff's side. This would destroy diversity. The question of alignment does not arise however if Tucker Corporation is not a necessary party because only indispensable parties need be regarded in testing diversity. *Salem Trust Co.* v. *Manufacturers' Finance Co.*, 264 U. S. 182.

"The complaint shows that Crowell-Collier Publishing Company and Tucker Corporation are Delaware corporations and that the plaintiff is a citizen of Illinois. The complaint shows also that Tucker Corporation is the debtor in a proceeding under Chapter X of the Bankruptcy Act; that on March 3, 1949, a voluntary petition for reorganization was approved and trustees were appointed in the United States District Court for the Northern District of Illinois.

"The plaintiff alleges that the cause of action was abandoned by the surviving trustee and thereby has reverted to the corporation. In his complaint he also says:

> " '13. Tucker Corporation has been named a formal defendant in this action to meet the formal requirement that the stockholder's corporation be made a party plaintiff or defendant in a stockholder's action. It being impossible to have the corporation join as a party plaintiff for the reasons aforesaid, it has been named as a formal defendant. However, as appears on the face of this complaint, no money judgment or other relief is sought respecting it or any of its property, save only the preservation and enforcement of this cause of action.'

"It is the settled law that in a derivative shareholder's action the corporation is a necessary party. *Davenport* v. *Dows*, 85 U. S. 626.

"There are, however, exceptions. It has been held that a corporation is not a necessary party to such actions if it has been dissolved or is defunct. *McClean* v. *Bradley*, 282 Fed. 1011; *Weinert* v. *Kinkel*, 71 N. E. 2d 445.

"Another exception arises when a corporation is placed in receivership. The corporation's property is in *custia legis*. Consequently, the right to enforce a stockholder's derivative action and 'all other rights of property of the corporation vests in the receiver, and he is the party to bring suit, and, if he does not himself sue, should properly be made a defendant to any suit by stockholders in the right of the corporation.'

Porter v. *Sabin*, 149 U. S. 473, 478. It follows that under such circumstances, the corporation is not a necessary party but is merely nominal.

"This reasoning is equally applicable in a bankruptcy proceeding, where, under § 186 of the Bankruptcy Act, the reorganization trustee is vested with complete legal title to all the property, including rights of action, of the debtor. *Gochenour* v. *Cleveland Terminals Bldg. Co.*, 118 F. 2d 89. The conclusion that the debtor corporation is not a necessary party is inescapable when considered in connection with the settled rule that the bankruptcy court 'has exclusive authority to determine how causes of action which have become a part of the bankruptcy estate shall be enforced.' *Meyer* v. *Fleming*, 327 U. S. 161.

"Plaintiff's contention that this alleged cause of action was abandoned by the trustee cannot be sustained. The Appellate Court of Illinois on February 2, 1953, in *Schmidt* v. *Crowell-Collier Publishing Company, et al.*, 110 N. E. 2d 464, dealt with this identical contention and concluded that there had been no abandonment by the trustee through any order of court. It also held that the stockholder's remedy lies within the bankruptcy proceeding and not by his unauthorized suit in behalf of the corporation. The Court said:

> " 'If the assets of the corporation have passed to a trustee in bankruptcy the stockholder must request the trustee to institute suit and, if he declines, petition the court before whom the proceeding is pending to direct the trustee to bring suit or authorize the stockholder to sue.'

"The holding of the Illinois Appellate Court is adopted as is the holding in *Gochenour* v. *George & Francis Ball Foundation, et al.*, 35 F. Supp. 508, where a similar contention was made.

"It is concluded that the plaintiff's motion to remand should be denied.

"The defendant Crowell-Collier Publishing Company's motion to dismiss this action must be granted. Much of what has been said in connection with the motion to remand is applicable to this motion. *Meyer*

> v. *Fleming*, and *Gochenour* v. *Cleveland Terminal Bldg. Co., supra*, lay down the rule that the bankruptcy court alone has the right to determine whether a cause of action belonging to the corporation should be instituted and which cause of action, except for the bankruptcy proceeding, might have been the subject of a shareholder's derivative suit. *Cf. Porter* v. *Sabin, supra.* Since the bankruptcy court did not authorize the instant action, it must be dismissed."

It was necessary to examine and to analyze the complaint in order to determine whether the Tucker Corporation was an indispensable party. There occurs to us no other means of determining whether or not a party is an indispensable party.

76 Corpus Juris, Removal of Causes, 1150-2, in addition to the language which the petitioner quotes therefrom at petition page 30, logically goes on to say that the allegations of the complaint are examined upon such issues as, for example, to determine whether parties are indispensable (page 1150, footnote, 74), to determine whether or not there are separable controversies (page 1150), or to determine whether there is a joint controversy (page 1152), and that such examinations are "not for the purpose of determining the cause on the merits" (page 1152) but for the purpose of determining the feature pertinent to retention of jurisdiction or remanding. The Court looks at "the well pleaded facts set forth therein, not the legal conclusions drawn from those facts" (page 1151). None of the cases cited by petitioner are in any respect contrary thereto.

The Court of Appeals, 210 F. (2d) 908, affirmed the District Court saying (913):

> "So in this case the cause of action for libel, assuming such claim existed, was owned not by the Tucker Corporation but rather by the trustee, subject to the exclusive control of the court in which the Chapter X

proceedings had been filed. Any judgment respecting such a claim, to be final and binding, necessarily would have to conclude the trustee. Under these circumstances, we think the corporation could rightly be disregarded as a party to the suit. Its citizenship was not, therefore, relevant to the question of diversity jurisdiction."

Petitioner, page 37, says that *Schmidt* v. *United States*, 198 F. (2d) 32, cert. den. 344 U. S. 896, supports his position. In that action which also arose out of the affairs of Tucker Corporation, he sought by derivative action to sue the United States for damages because the Securities and Exchange Commission had made a full investigation which was claimed to have resulted in the closing down of the business of Tucker Corporation. The Court of Appeals saw fit to meet upon the merits of the allegations of the complaint that theory of liability of the United States because the Securities and Exchange Commission was claimed to have stopped Tucker Corporation's activities. The opinion of the Court said: "* * * it makes it unnecessary for us to consider the third and fourth grounds," which included the point of his ability to maintain a derivative suit.

Upon Approval of a Petition for Reorganization Under Chapter X, the Property of the Debtor Vests in the Trustee, 11 U. S. C. A., Sec. 110, 586.

A cause of action for libel *to a corporation*, which cause of action existed at the time of approval of the bankruptcy petition, would go to the trustees because involving an injury to the bankrupt's property which vests in the trustees. 11 U. S. C. A. Sec. 110, sub. a(5); *In re New York Woman, Inc.*, 34 F. Supp. 831; *Empire Tractor Corp.* v. *Time, Inc.*, 91 F. Supp. 311; *Collier on Bankruptcy*, 14th ed., vol. 4, Sec. 70.28, p. 1163. Obviously, a cause of action for libel

arising *after* the vesting of the property and business in the trustees would vest in them.

Petitioner cites no case in which *a derivative action for libel* has been considered. A derivative action for libel is unusual. And petitioner cites no case in which anyone has sought to separate a corporate cause of action for libel from the business and assets which necessarily the action concerned.

The Exclusive Character of the Bankruptcy Court's Control.

In *Meyer* v. *Fleming*, 327 U. S. 161, the Court said (169):

> "If the claim were to be filed after the petition for reorganization—had been approved, it could be done only with the consent of the bankruptcy court. For it has exclusive authority to determine how causes of action which have become a part of the bankruptcy estate shall be enforced."

In *Trimble* v. *Woodhead*, 102 U. S. 647, the Court said (650):

> "If he is aware of the existence of property or credits, * * * he should inform the assignee * * * and request him to proceed * * *. If he declines, a petition to the court of original jurisdiction would, if a proper case was made, compel the assignee to proceed."

In *Glenny* v. *Langdon*, 98 U. S. 20, the Court said (29):

> "* * * if it be represented that the assignees will not sue, the court having jurisdiction of the matter may direct the recusant assignees to proceed, or may give the bankrupt or a creditor the right to institute the suit in the name of the assignee, first indemnifying the assignee against costs."

In *Klein* v. *Peter*, 284 Fed. 797 (C. A. 8), the Court said (799-800):

> "* * * a stockholder cannot sue without the sanc-

tion of the court appointing the receiver * * *. Appellants had and have a complete remedy for any wrongs inflicted, in the court appointing the receiver * * *. If the receiver was not willing to do his duty he could be removed. If appellants were not satisfied with the order of the trial court refusing authority to the receiver to bring action against appellees, they could appeal."

Plaintiff's Argument of Abandonment.

What does the petitioner mean by "abandonment"? In his reply brief in the Court of Appeals, he finally told us (Court of Appeals reply brief, page 54):

> "Abandonment re-vests legal title to the asset or causes of action *in the debtor corporation free from the estate and its creditors*, and it is this title which the stockholder sues upon in his derivative action. * * * Their [the creditors'] means of recovery necessarily lies in keeping the asset vested in the estate and having it enforced there, which is their normal and probably only method of realizing upon such assets." (Italics ours.)

We are not clear how such a cause of action "re-vests" in a corporate shell which had been deprived of its business and assets before the article was published.

Irrespective of that consideration, it is petitioner's theory that the attorney for the trustees of a bankrupt corporation can be talked out of what the petitioner considers to be a valuable cause of action, with the result that the creditors lose their interest therein and the stockholders gain what the petitioner must consider to be a windfall. Further, it is petitioner's theory that that can be accomplished during the pendency of the bankruptcy proceeding and without any notice to the creditors and without an appropriate order of court. Suffice it to say that the petitioner cites no authority for such a remarkable result.

The shell of Tucker Corporation enjoys no exemptions under the Bankruptcy Act and continues to owe its creditors until they are satisfied or enjoined. By whatever means money may find its way to the shell of Tucker Corporation during the pendency of the bankruptcy proceeding, we assume that the money belongs to the trustees, first for expenses of administration and Tucker Corporation's creditors.

If an action by the debtor corporation is pending when the petition in bankruptcy reorganization is approved, the trustees need not take it over and may ignore it, and still the trustees are entitled to and will take any proceeds of the litigation. *Meyer* v. *Fleming*, 327 U. S. 161; *Johnson* v. *Collier*, 222 U. S. 538. It follows necessarily that when the cause of action *arises* in the bankruptcy trustees it remains under the exclusive control of the bankruptcy court during the pendency of the bankruptcy proceedings or until duly satisfied or until duly sold and duly assigned, if it be subject to assignment.

The Order Which Petitioner Neither Obtained Nor Sought.

We find it interesting to examine what kind of an order might have been expected.

1. Order that the trustees sue.

Schmidt could have filed a petition that the trustees be ordered to sue. That is the normal procedure. *Glenny* v. *Langdon*, 98 U. S. 20, 29; *Trimble* v. *Woodhead*, 102 U. S. 647, 650.

2. Denial of order that the trustees sue.

If the Court denied an order directing the trustees to sue, there would have been no remedy except to appeal.

Denial of an order directing the trustees to sue does not entitle the corporation or its representatives to sue. *Porter* v. *Sabin,* 149 U. S. 473; *Klein* v. *Peter,* 284 F. 797 (C. A. 8).

There is no logical deduction from the trustees' failure to sue that the cause of action is thereby assigned or abandoned to the petitioner (even if the cause of action could survive such assignment). *Gochenour* v. *Ball Foundation,* 35 F. Supp. 508, 117 F. (2d) 259 (C. A. 7), *cert. den.* 313 U. S. 566, says (518):

> "The failure of the debtor [no trustee named in the bankruptcy proceeding in Cleveland] to assert a cause of action against defendants in this case is not sufficient to authorize this court [the U. S. District Court, Indianapolis] to hold that the action has been abandoned and that, therefore, these plaintiffs have a right to maintain it. * * * Such cause of action is under the exclusive jurisdiction of the bankruptcy court."

Indeed, if there had been no bankruptcy and if this were a real, derivative suit, it would have failed upon the allegations of this complaint. Equity does not recognize a stockholder's derivative suit when *merely* the plaintiff stockholder disagrees with the Board of Directors who in good faith think the action is not worth while. Courts do not force corporate litigation *merely* because there is some one stockholder somewhere who would like to litigate. *Dodge* v. *Woolsey,* 59 U. S. 331; *Hawes* v. *Oakland,* 104 U. S. 450; *Doctor* v. *Harrington,* 196 U. S. 579; *Corbus* v. *Gold Mining Co.,* 187 U. S. 455; *United Copper Co.* v. *Amalgamated Copper Co.,* 244 U. S. 261.

The *right not to sue,* particularly as respects an action for libel, is as much a right as the right to sue. A libel suit reviewing the details of the unfortunate enterprise might not aid the disposition of the business and assets upon a favorable basis.

3. Order that the petitioner be permitted to sue in place of the trustees.

Inasmuch as the Court of bankruptcy had exclusive control of the cause of action, that Court could have authorized the petitioner to sue upon behalf of the trustees. *Glenny* v. *Langdon*, 98 U. S. 20, 29; *Gochenour* v. *Ball Foundation*, 35 F. Supp. 508, 117 F. (2d) 259, *cert. den.* 313 U. S. 566.

Obviously, any recovery would belong to the trustees. *Meyer* v. *Fleming*, 327 U. S. 161; *Johnson* v. *Collier*, 222 U. S. 538.

4. Order that the cause of action be assigned or abandoned to the corporation or to the plaintiff.

Such an order, without consideration, would be most unusual, and no reason would appear for entering it. As indicated, we have questioned whether the action, if any, could be separated from the business and assets. No case is cited that it can be.

Petitioner's argument is really nothing more than that because the trustees had not sued during the one year and eight months of the Indiana two year period of limitations and because the trustees' counsel did not believe in the action, the petitioner was entitled to proceed. Neither law nor logic supports that conclusion.

The Illinois courts considered the same complaint filed by the same plaintiff against the same defendants. *Schmidt* v. *The Crowell-Collier Pub. Co.*, 349 Ill. App. 229, 110 N. E. (2d) 464, leave to app. den. 414 Ill. 628, concluded at page 234:

> "His right to maintain this suit depends wholly on the sufficiency of the averments in the complaint to show abandonment of the cause of action and its re-

version to the corporation. He relies strongly on *In re Malcom* (Dist. Ct. E. D. Ill. 1943), 48 F. Supp. 675, and cases cited therein, holding that no formal petition for or order of abandonment is neecssary. These cases are applications for leave to reopen estates and suits involving title between third persons and the bankrupts or their successors in interest. They are decided on equitable principles—estoppel and laches. The controversies therein over the claimed abandonment arose after the closing of the estates. While the bankruptcy proceeding is pending, orders may be entered therein determining the controversy.

"Plaintiff bases his claim upon the matters hereinbefore stated. The conversation with and letter to the attorney for the trustee bound neither the trustee nor the court. The sending of copies of the letter to the trustee and the court was equally ineffective. The court acts only through its orders. It could acquiesce in and ratify an abandonment of the cause of action only by an order authorizing or confirming the abandonment. No order of that nature was entered."

Though the time never arrived for us to file an answer, we filed in the Court of Appeals a motion for dismissal upon the ground of *res adjudicata* on account of the final disposition by the Illinois courts, relying upon *Hart Steel Co.* v. *Railway Supply Co.*, 244 U. S. 294. The Court of Appeals said (911):

"In the view which we take of the cases before us, we need not consider whether the Illinois judgment in the Crowell-Collier case should be considered res adjudicata."

Petitioner's brief makes various assertions about the law of abandonment. We have not found among the cases which he cites any case which contemplated or permitted during pendency of a bankruptcy proceeding any realization and retention by a bankrupt *corporation* or its stockholders, exclusive of its creditors, under any circum-

stances whatever. We fail to see any reason or logic in support of any such preference to the empty shell of a corporation or its stockholders when administrative expenses and creditors are to be paid.

The *Malcom* case, upon which the petitioner principally relies, involved an *individual* bankrupt who was discharged after nothing had been done respecting a heavily encumbered parcel of real estate. It would indeed have been inequitable, many years later after the recovered bankrupt had paid off the mortgage, to have deprived him of his property.

As the Illinois decision points out, "while the bankruptcy proceeding is pending, orders may be entered therein determining the controversy." We respectfully submit that without notice to parties to the proceeding and without an *appropriate order of Court*, petitioner could accomplish nothing by the procedure which he followed. There can be no proper reason suggested why he did not follow the readily available remedy of presenting the matter to the bankruptcy court and asking some one of the orders we have indicated above. Petitioner suggests pressure of time, but the two-year Statute of Limitations in Indiana still had four months yet to run.

There was an injunction pending against any interference with the property or assets of the trusteeship (R. 55-6), and there was no modification thereof.

Furthermore, as pointed out by the Court of Appeals, Bankruptcy Rule 19 of the United States District Court for the Northern District of Illinois provided for abandonment "*upon approval by the Court*" of "any property of the bankrupt if burdensome or of no net realizable value."

Collier on Bankruptcy (14th ed.), Vol. 4, p. 1210, note, cites similar rule 15 for the Southern District of New

York and similar rule in the Eastern District of New York.

The said rules show the recognition of the necessity in the orderly administration of bankruptcy to require any attempted disposition of assets during the pendency of the proceeding to be by Court order.

We respectfully submit that the District Court and the Court of Appeals were clearly correct in their determination that Tucker Corporation was not an indispensable party, and in refusing to remand the case to the State court.

Respectfully submitted,

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